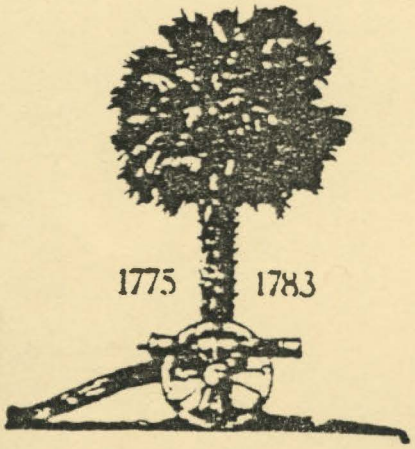
South Carolina General Assembly

Legislative Audit Council



South Carolina General Assembly
Legislative Audit Council
Sunset Review of the Insurance Commission/Department of Insurance
June 27, 1979

THE STATE OF SOUTH CAROLINA

GENERAL ASSEMBLY

LEGISLATIVE AUDIT COUNCIL

SUNSET REVIEW OF THE

INSURANCE COMMISSION/

DEPARTMENT OF INSURANCE

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REPORT SUMMARY

Introduction

In July 1978 the General Assembly passed Act 608 which has become known as the "Sunset Act." This Act abolishes specific boards and commissions as of predetermined dates and requires the Legislative Audit Council to review each board/commission one year prior to its termination date. The Insurance Commission/Insurance Department is scheduled to terminate on June 30, 1980 and was the first agency to be reviewed by the Council. In addition to the Sunset mandate the Council was also requested by a member of the General Assembly to review the Department of Insurance.

The Sunset legislation mandates the Council to make a "review and evaluation of the specific programs and functions administered" by the Department of Insurance. In this regard the Council examined the Department's regulatory duties, functions, policies, and procedures and reviewed the specific type of insurance systems regulated by the Department. This included an analysis of accident and health insurance, industrial life insurance and automobile insurance.

South Carolina's automobile insurance system was studied in detail because (1) automobile insurance is required for all drivers by law, thus it affects a majority of South Carolinians and (2) it is more heavily regulated than any other type of insurance. In reviewing the effectiveness of automobile insurance in this State, the Council analyzed systems, mechanisms and programs used in regulating automobile insurance in other states. In examining these systems and programs the one major

alternative system used was found to be no-fault insurance. For this reason no-fault insurance was studied in conjunction with evaluating South Carolina's present system.

In performing this audit the Council conducted numerous and detailed interviews with Department staff and management. Department files, records, memos, reports, policies and procedures were reviewed and analyzed. Council staff attended Insurance Commission meetings, rate review committee meetings, rate request hearings, and administrative hearings on agent conduct. Questionnaires dealing with the Insurance Department and South Carolina's insurance system were prepared and sent to the general public, insurance companies, licensed agents and to persons who had filed insurance related complaints with the Department. Industry representatives, associations and organizations were contacted and supplied the Council with much information.

In addition, other states were contacted and supplied the Council with data and expertise on insurance and regulation in general. A sharp contrast was noted between South Carolina and North Carolina's automobile liability rates. North Carolina's liability rates are the lowest in the nation. Many factors appear to contribute to this difference including the structure of the judicial system and the driving habits of the population. Some of these factors are reviewed in Appendix III (page 128). An adequate analysis of these factors would require a comprehensive study involving several agencies including the Department of Highways and Public Transportation, the Department of Insurance and the State Judicial Department. A review of this nature was beyond the scope of this audit.

The Audit Council concludes from its review that there is a public need for the regulation of insurance and the Department of Insurance should not be terminated. In most areas the Department's administration of its regulatory duties is efficient and effective. However, there are areas where improvements are needed not only within the Department but within the insurance system itself. These areas are summarized in the following pages.

Department of Insurance - Management and Administration (Chapter 2, p. 22)

The Audit Council made a comprehensive evaluation of the Department of Insurance and found major problems which point to a need for improved leadership and initiative by the Department in addressing some of the real issues in South Carolina's insurance system. Constructive and imaginative work in these areas can result in improvements in many facets of the marketplace and could result in better benefits to policyholders at a lower cost. Inaction will only result in increasing costs and poorer service. The major findings identified by the Council are:

(1) Standards for Individual Accident and Health Insurance Should Be Established (p. 29)

The Department of Insurance has not established minimum standards for individual accident and health policies. Although these standards were mandated by the General Assembly in 1975 (Act 253) they have not been established by the Department. As

a result South Carolina consumers are without the protection provided by the Act from substandard policies in the marketplace. This creates a climate for potential abuse, especially of the poor and elderly, who are major victims of substandard policies. The Department was found not to be carrying out its statutory responsibility in this important area.

(2) Regulation of Industrial Insurance Needed (p. 35)

The State lacks effective regulations governing the sale and content of industrial (debit) insurance. This type of insurance is sold predominantly to the poor and payments are made on a weekly or monthly basis. Recently there have been numerous charges on a national level that the industrial insurance industry has been engaging in widespread fraud and consumer "ripoffs." Also it has been well documented that industrial insurance is a low value product and its prime consumers, the poor, frequently lack even a fundamental understanding of the policies and benefits. Some South Carolina laws regulating life insurance do not apply to industrial life insurance. The Department has made no recommendation to extend regulation in this area even though there is a need for regulation. Also the Department maintains little information on industrial insurance sales in the State. At present the industrial insurance industry is sheltered from oversight and accountability while the consumers of industrial insurance are left unprotected.

(3) Need for Evaluation and Monitoring of the South Carolina Insurance System (p. 22)

The Department of Insurance lacks programs to research, monitor and evaluate problems within the insurance system. Evaluation and monitoring are the primary methods of determining the effectiveness of any system. These methods are especially necessary in dealing with a system as complex and important as the insurance system. Although the Department does collect massive amounts of data concerning insurance in the State, little of this data is analyzed and formulated into useful information. South Carolina has a need for information on its insurance system so that major programs can be evaluated and realistic goals established. Without this type of comprehensive perspective the processes of decision-making and planning are severely hampered.

(4) Consumer Protection and Assistance Should Be Strengthened (p. 41)

Consumer protection is a major responsibility of any regulatory agency. The Council identified four problem areas which stem from an overall lack of program design, and oversight in the marketplace by the Department. These are:

(a) Lack of field investigations.

(b) Limited public accessibility to the Department's consumer assistants.

(c) Scarcity of public information programs on insurance.

(d) Lack of public information on the conduct of insurance companies.

Monitoring of the marketplace is of primary importance to a regulatory agency. Recognizing consumer abuse can lead to identification of other problem areas within companies such as financial

instability. Also public input is invaluable in the formulation of public policy. The State needs an informed and protected general public which recognizes its own needs and is free from unfair market practices. Currently the Department is not meeting these needs.

(5) Violation of State Laws Concerning Travel Reimbursement (p. 49)

Financial examiners from the Department are being reimbursed at a different rate for travel expenses than other State employees. In some cases financial examiners were overcompensated and in many cases they were found to be undercompensated. Also financial examiners are reimbursed for expenses directly by insurance companies rather than by the Insurance Department. These inconsistencies have existed for years and have been approved by the Insurance Commission even though they violate State law.

(6) Need for Continuing Education Requirement for Insurance Agents (p. 52)

The Department has developed no requirements which mandate that insurance agents participate in continuing education coursework in order to maintain their licenses. Even though Department officials favor such requirements the Department has taken no initiative in establishing them. Many other states do require continuing education and the National Association of Insurance Commissioners (NAIC) has promulgated model legislation on this subject. Also most insurance companies offer regular coursework and local agents' associations contacted by the Audit Council endorse this concept. Continuing education has the dual effect of ensuring

that agents are more knowledgeable and aid in "weeding out" incompetent agents. The Department has provided no leadership in attaining this necessary goal.

South Carolina's Automobile Insurance System (Chapter 3, p. 68)

The impact of automobile insurance on the lives of nearly all South Carolinians and the constant controversy which surrounds automobile insurance along with the Council's mandate to evaluate specific programs regulated by the Department prompted the Council to review this type of insurance in detail. The last major legislative action came in 1974 with the passage of Act 1177, the Automobile Reparations Reform Act. This legislation sought to correct the many problems in the automobile insurance system. Until passage of this Act there were major inequities in the system. Also there were problems in affordability, availability and financial responsibility. The Council reviewed this Act and its effect on the system over the past five years and concluded that many of the positive objectives have been achieved. Auto insurance is now fully available and its price structure is more equitable than before. However, there are still several problem areas:

(1) Current Risk Classification Plan is Discriminatory (p. 79)

Act 1177 removed most of the more obvious forms of discrimination such as those based on race, occupation and other subjective judgments. However, rates are still based on the applicant's sex, age and marital status - factors over which a person has no control. A more equitable method of rate discrimination is to base rates on driving experience and driving record. By doing this other states have placed a larger degree of control of rates in the hands of the individual driver.

(2) Merit Rating Plan Not Effective (p. 82)

In South Carolina drivers are surcharged for their accidents and other violations as an incentive to promote safer driving. The Council evaluated South Carolina's merit rating plan and reviewed other states' use of such a surcharge. The Council has determined that the level of penalties in South Carolina should be strengthened to provide a more effective deterrent to unsafe driving. In addition the surcharge plan does not appear to be fully enforced. Currently there is not a system which automatically notifies insurance companies of a person's traffic violations. As a result many individuals have not been held fully accountable for their bad driving and the goal of lower losses and fewer accidents has not been met.

Overall the Council determined that the automobile insurance system has improved since 1974 with the passage of Act 1177. However, revisions to the risk classification plan and merit rating plan are needed.

No-Fault Insurance (Chapter 4, p. 87)

Act 1177 dealt mainly with the distribution of the insurance system's cost to the policyholder. It did not affect the timely and efficient provision of benefits to accident victims. The Council examined the State's current system of compensating accident victims, the tort liability system, and found that it contains inherent weaknesses and inequities. The tort liability system places emphasis on the involvement of the judicial process and the proving of fault. It is inefficient, generally provides inadequate levels of compensation, discourages rehabilitation, does not distribute benefits fairly and contains other serious inequities.

No-fault insurance was designed to remedy these weaknesses. In a "pure" no-fault system benefits have proven to be more adequate, especially for serious accident victims. Also compensation is more timely, and no-fault insurance can be coordinated with other insurance plans in order to eliminate duplication of coverages. It also reduces the use of courts and encourages rehabilitation.

The Council performed a detailed study of no-fault insurance and the experience of the sixteen no-fault states and concluded that South Carolina citizens would benefit greatly from a "pure" no-fault system. Such a system, however, should reflect a total commitment by the State in replacing the present tort liability system. Otherwise the result will merely be the placing of one reparation system on top of another, thus causing more problems than it will solve.

Conclusion

The Legislative Audit Council has found from its review and evaluation of the Department of Insurance's programs, functions and regulatory duties that the public is served by the regulation of the insurance industry and that the Department should not be terminated. However, in some areas of insurance regulation in South Carolina the Department must begin to provide more leadership, expertise, and initiative.

The Department must begin to gather and analyze relevant cost data, use its expertise in analyzing the effectiveness of South Carolina's insurance system and provide this information to the General Assembly and the public. It must promulgate and implement accident and health insurance regulations to better protect the poor and the elderly.

Industrial life insurance needs to be more closely watched to assure that the public is getting adequate benefits for the premiums paid. Increased assistance to consumers and monitoring of the marketplace are also areas where improvements can be made.

The Department of Insurance is South Carolina's expert in the area of insurance. In the absence of its leadership and initiative no other agency or group has the resources to act in the public interest. The Department must exercise its leadership responsibilities and expertise to move the State toward the goal of having the best insurance system possible.

The major insurance reform of this decade, Act 1177, can achieve the goal of equity in premium distribution with some improvements. However, there is a need for reform in the provision and distribution of benefits. A properly designed and implemented no-fault insurance system is a viable alternative and has proven to be superior in its delivery of benefits to accident victims in a timely, equitable and efficient manner.

Following this summary, the report is divided into four chapters. Chapter 1 gives a background and history of insurance and the Department's operation. Chapter 2 is the result of the Council's evaluation of the Department's management and administration with findings and recommendations. South Carolina's automobile insurance system is evaluated along with the review of the no-fault insurance alternative in Chapters 3 and 4.

CHAPTER 1

BACKGROUND

In South Carolina insurance is a billion dollar industry that reaches into the lives of nearly every State citizen. Every South Carolinian who owns a motor vehicle must maintain insurance, and everyone who owns a home most likely has homeowners insurance. Health and life insurance have become financial safeguards few can live without. Thus, it is not surprising that South Carolinians spent $1.6 billion on insurance in 1977.

Without this protection against the hazards of driving a car or becoming sick, day-to-day living would become more risky. People would never know when sickness or accident would wipe them out financially. Insurance reduces this uncertainty by allowing people to pool their risks. It enables consumers to pay a small amount now in order to avoid future financial disaster.

Regulation of this vital industry was entrusted to the states when the Federal Government ruled that, while insurance was a part of interstate commerce, it was exempted from Federal oversight to the extent it was regulated by the states.

South Carolina established a Department of Insurance in 1908. In 1960 the Department was placed under the control and administration of a five-member Insurance Commission. The members of the Commission are appointed by the Governor and at least three members are selected from the "general public" and have no connection with the insurance industry. The Commission was formed, following the indictment of the Chief Insurance Commissioner at that time, under the rationale that no

one man should be vested with full power over the Department, and that policy decisions should have input from citizens who are immune from political pressures and who have no vested interests in the insurance industry.

The statutes charge the Commission with the responsibility for hiring the Chief Insurance Commissioner and enforcing the State laws governing insurance companies. In this role the Commission offers its "counsel and advice" to the Chief Insurance Commissioner and must be consulted before the Chief Insurance Commissioner can make decisions on rate increases, major disciplinary actions, new regulations, legislative recommendations and other major activities.

The Commission meets once a month but is briefed periodically by Department staff. The Chief Insurance Commissioner is the administrative head of the Department and he is charged with overseeing its day-to-day work.

The last major reorganization of the Department was in 1975 based on the recommendation of a management study by McKinsey and Co., Inc., a major consulting firm. This study reorganized the Department consistent with its three prime functions: protecting against company insolvency; ensuring fair treatment of policyholders and claimants; and administering taxation and licensing statutes. The Department currently has five divisions: administration and legal services, licensing and taxation, market conduct, financial condition, and the State rating and statistical division (see organization chart, p. 20).

Administration and Legal Services Division

The Department now employs 106 classified staff members. Operating expenses totaled $2,624,896 for FY 77-78, of which 62% was used for personnel, 22% for data processing and the rest for other administrative expenses. The operating budget has doubled in the past five years, largely due to increased duties mandated by the General Assembly, but the number of employees has remained the same. The revenue the Department collects from the insurance industry - $32,726,702 in 1978 - has increased 53% in the last five years, adding more than $129 million to the State General Fund (see Table 2, p. 21).

The Administration Division is in charge of personnel, property control, procurement, budgeting, travel and contractual services. Data processing services within the Department also are under the Administration Division's supervision.

The major provider of contractual services to the Department is the Automobile Insurance Plan Services Offices (AIPSO), a statistical reporting firm that furnishes data on auto insurance. The Department employs a system consultant to oversee the functions handled by AIPSO.

In FY 77-78, the total cost of auto insurance data processing was $735,990. AIPSO costs were $540,072 of the total with the remaining $195,928 going for Department personnel and the system consultant. The entire $735,990 was reimbursed to the State through assessments to automobile insurance companies.

The Department also uses electronic data processing equipment to keep financial records and information on agent and company licenses. The Department works with the Division of General Services' data processing staff to provide this information.

The Legal Services Division is responsible for overseeing the process of agent license revocation. It acts as the Department's legal counsel at hearings, prepares interpretations of new legislation, and represent the Department during court proceedings.

Licensing and Taxation Division

The duties of the Licensing and Taxation Division are two-fold: to examine and license insurance agents, brokers and adjusters and collect fees from them; and to regulate the licensing and taxation of insurance companies.

The duties of the agent licensing section are mainly clerical. Agents are tested after they apply for a license and can take the exam at several locations throughout the State. An insurance company must sponsor the agent and pay the examination fee before the agent can be licensed. The division is in charge of keeping tests up-to-date and issuing examination schedules. During 1977, 4,630 agent examinations were given and of these 3,080 or 67% received a passing grade.

The 21,809 agents licensed (as of February 5, 1979) hold a total of 56,841 licenses, which are issued on a permanent basis but must be renewed annually with a basic fee of $10. Information on agents and the number and type of licenses each one possesses is kept on-line in the Department's data system. During FY 77-78, total agent fee collections accounted for $736,385.

The company licensing and taxation section enforces South Carolina Statutes, which specify the conditions companies must meet before they can do business in this State, and how they are to be taxed (Section 38, Chapter 5 of the 1976 Code of Laws). When a company applies for

a license to do business in South Carolina, this section, in conjunction with the Financial Condition Division, reviews the company's financial status and notifies it of all South Carolina requirements. Often companies must deposit securities which are monitored by this section to ensure their value is maintained.

Companies also renew their licenses annually upon payment of a fee. Taxes, too, are collected yearly and in order to do this each company must file an annual statement with the Department. The company licensing and taxation section then determines the tax each company owes based on its premium volume. During FY 77-78, $32,726,702 in company and agents fees and taxes was collected. As of February 1979, 1,001 insurance companies are licensed in South Carolina.

Financial Condition Division

The Financial Condition Division is charged by State law to guard against insurance company insolvencies and the adverse impact such insolvencies would have on South Carolina policyholders. A dual approach is used to detect the underlying conditions which may precede insolvency: first, annual statements are subjected to a desk-based analysis; and second, financial records maintained at company home offices are audited. To carry out these duties the Division is divided into two sections: financial analysis and financial examination.

The six financial analysts study companies' annual statements in conjunction with NAIC Early Warning System reports in order to pinpoint problem areas. If problems are spotted a company may be examined further and be required to submit financial reports on a quarterly, instead of an annual, basis. The company then may be

scheduled for an on-site examination if further analysis reveals it is in financial danger.

The 15 financial examiners conduct on-site examinations of all domestic companies every three years, and participate in examinations of foreign (out-of-state) insurance companies. In addition to the standard examinations every three years, insurers may be examined in response to conditions such as poor results on Early Warning System tests or abrupt changes in company management.

From November 1975 through November 1978, the financial examination section conducted on-site analyses of 89 domestic companies and participated in the examination of 17 foreign insurance companies. During this period the licenses of four foreign companies were revoked due to examination findings. Also during this time, 10 companies voluntarily surrendered their licenses due to inadequate volume of business or merger with another company.

Market Conduct Division

The function of the Market Conduct Division is to protect policyholders and claimants from unfair practices in the marketplace. Consumer complaints and inquiries from the public are directed to this Division and channeled to one of seven consumer assistants. The consumer assistant notifies the insurance company of the nature of the complaint, and tells the complainant that action has been initiated. The consumer assistant and the company correspond until the complaint has been resolved - which may be either to the satisfaction or dissatisfaction of the consumer. The sole responsibility of the Division is to ensure that the law has not been violated.

The Division maintains monthly records on the number and the nature of complaints it receives. In addition, it compiles this information in a yearly report to identify major areas of complaints and how many complaints are received by each company licensed in the State. During 1978 there were 3,347 complaints received of which 2,406 were "successfully" resolved. The Division also processed 3,625 inquiries for information.

The Division has set up a small field investigation unit consisting of a full-time and a part-time investigator. During FY 77-78, 55 investigations were performed. They mainly resulted from complaints alleging agent misrepresentation of insurance policies. If the Division investigators collect evidence to substantiate the allegations of misconduct, the case may be turned over to the Department's legal division for possible administrative or criminal proceedings.

State Rating and Statistical Division

The State Rating and Statistical Division, established by Act 1177 in 1974, was created by combining the old Life, Accident and Health section and the Property and Casualty section. It is presently divided into two sections: Auto Rating, and Forms and Rates.

South Carolina statutes charge the Auto Rating section with three major duties: to promulgate risk classification plans for auto insurance; to establish the statistical plans necessary to compile data on the insurance premiums and losses; and to make sure auto insurance rates are adequate, not excessive nor unfairly discriminatory.

Companies must file detailed information when they request a rate increase, and this is analyzed by the auto rating analysts and the

property and casualty actuary. South Carolina statutes establish a procedure for rate hearings, and the property and casualty actuary performs an independent analysis of the rate request (see p. 56).

In order to gather statistical information on auto insurance premiums and losses, and on the validity of the risk classification plans, the Department has contracted with the Auto Insurance Plans Services Office (AIPSO). AIPSO collects data from insurance companies and sends it to the Department. The actuary uses this data in his analysis of insurance rates and the methods used to classify drivers.

Other duties of the Auto Rating section include supervising any underwriting audits that may be conducted to see if auto insurers are obeying the law; maintaining a liaison with the Reinsurance Facility; processing policies and forms for all private and commercial auto insurance, mobile home insurance and bank insurance on car loans; compiling other statistical information, and answering technical questions from the general public and insurance companies.

During FY 77-78 the Auto Rating section processed 1,276 rate and policy filings. Of these, 937 were approved, 175 disapproved and the rest withdrawn or pending. The Division conducted 21 public rate hearings.

The Forms and Rates section is given the authority to approve or disapprove policies and analyzes rate requests for individual and credit health insurance; fire, theft, homeowners and allied lines; liability other than auto; fidelity and surety insurance; and inland marine insurance. It also approves policies for group health insurance and all life insurance.

Health insurance analysts must determine that the premium cost of health insurance is reasonable in comparison with the benefits offered.

They base their analysis of policies on standards taken from South Carolina statutes, Department memos, regulations, bulletins and past and current positions taken by the Insurance Commission. The property and casualty analysts must determine that rates are adequate yet not excessive, and a rate hearing may also be held. All forms and rates analysts examine insurance policies to ensure they contain the required terminology and provisions.

The life actuary works with the health and life insurance analysts in this section and also works with the Financial Condition Division in examining life insurance companies and analyzing annual reports. During FY 77-78, four life, accident and health analysts processed 18,599 filings. The two property and casualty insurance analysts processed 6,270 filings.

TABLE 1

SOUTH CAROLINA DEPARTMENT OF INSURANCE ORGANIZATION

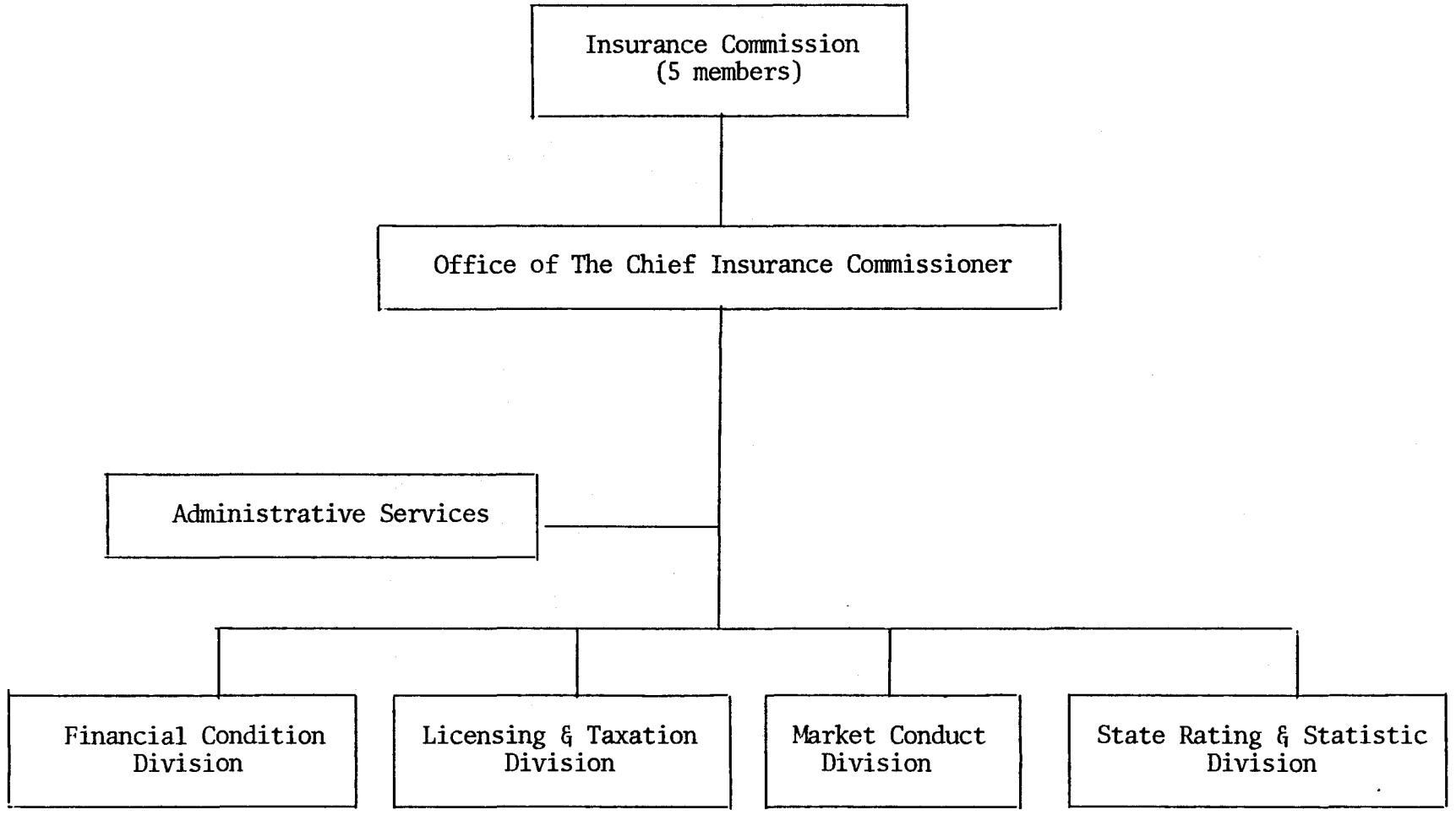


TABLE 2

FINANCIAL GROWTH OF S.C. DEPARTMENT OF INSURANCE

	1977-1978	1976-1977	1975-1976	1974-1975	1973-1974	% Growth Over 5 Year Period
Administration	$ 961,927	905,194	823,474	776,328	559,273	72%
Licensing & Taxation	$ 666,664	556,549	511,678	506,464	475,247	40%
Technical Services	$ 221,432	197,211	182,854	158,465	249,143	12%
State Rating & Statistical	$ 774,873	767,628	567,315	240,083	*	
Total Operating Expenses	$ 2,624,896	2,426,582	2,085,321	1,681,340	1,283,663	104%
Department Revenues	$ 32,726,702	28,708,393	24,177,443	22,499,802	21,406,630	53%
Contribution Margin (Operating Cost/Revenue)	8%	8.5%	8.6%	7.5%	6%	

Source: S. C. Budget and Control Board Annual Budget Requests.

*Division Created by 1974 Act 1177 of South Carolina General Assembly.

CHAPTER 2

INSURANCE DEPARTMENT - MANAGEMENT AND ADMINISTRATION

Introduction

One of the main duties of the South Carolina Insurance Department is the management and administration of the various insurance systems and programs of the State. Act 608 (The Sunset Act) mandates that the Audit Council "review and evaluate" the efficiency and effectiveness of this management and administration function. A prime concern of this review was the extent to which the public interest and welfare is served by the regulatory process. This chapter will examine problem areas identified by the Audit Council which significantly weaken the regulatory process and have an adverse affect on the public welfare. In addition recommendations are made which should enhance the ability of the Department to respond to the needs of the State.

Lack of Evaluation and Monitoring of the South Carolina Insurance System

The Department of Insurance lacks programs to research, monitor and evaluate problems within the insurance system. Such programs would afford the Department the means to spot consumer insurance problems before they developed into crises and to alleviate these problems. Although the Department collects routine data on the system, there is no impetus to formulate this data into useful information. No procedures exist to monitor the insurance system as a whole and its effects on the consumer.

The Department has monitored the insurance system to a limited extent (for example, staff members are "watching" certain lines of

insurance to make sure an availability problem does not develop), but little of the information collected has been examined and compiled into detailed analytical reports. The Department lacks relevant information on certain lines of insurance and does not fully use the information it does collect. For example, while consumer complaints are compiled by "type of complaint" and by the "insurance company involved," the Department does not widely publicize this data.

In particular the Department has not developed enough hard data to adequately analyze the effect of Act 1177 on auto insurance consumers. It does not know what effect the Act has had on premium rates or whether there will be a serious affordability problem in the future. It lacks data to show what effect the Act is having on tort litigation, the size of settlements and adequacy of benefits to accident victims. The Department of Insurance has published two written reports on auto insurance and concludes that Act 1177 "works," but it does not furnish any real data to support this conclusion.

The Department has yet to obtain the needed information with which to adequately assess the validity of the risk and territorial classification plans, even though the plans have been operative for more than three years and the Department can instruct AIPSO to furnish it with this data. Also, field audits are not conducted to obtain data useful to consumers. This type of field audit could yield consumer information on which companies pay claims fairly and promptly, or on the number of claimants who must sue in court to collect benefits. Just recently the Department completed a claims study of 16 auto insurance companies, although the data collected has yet to be compiled.

Department monitoring of individual accident and health insurance also has been ineffective. At least 21 of the top 50 companies writing accident and health insurance in South Carolina failed to meet a "benchmark" of a 50% loss ratio - that is, these companies returned less than 50 cents in benefits for every premium dollar earned. While this information has been available to the Department no one has made an effort to compile it and use this information in regulating health insurance companies. Except for the purposes of taxation and financial solvency analysis, the Department makes little use of the data furnished by companies in their annual reports.

Because it has not adequately researched and assessed consumer problems with insurance, the Department lacks priorities as to which problems it should tackle first. Setting priorities for problem solving is especially important if the Department is to use existing staff members to do research and analysis on insurance problems. The Department presently possesses the actuarial, data processing and legal capabilities necessary to perform studies of the insurance system, but this expertise has not been fully used in arriving at solutions to difficult problems.

The Department could enhance its research capabilities through closer cooperation with other State agencies. Currently there is a lack of involvement between the Department and agencies such as the Department of Highways and Public Transportation (DHPT) which could furnish the Department of Insurance with needed data on traffic losses or on the effectiveness of the Merit Rating Plan.

The Department also lacks an aggressive attitude toward reforming or improving aspects of the insurance system. This is partly due to its

belief that substantive changes can come only from the General Assembly. While this may be true it is the Department's responsibility to monitor the system, identify problem areas and make recommendations for concrete change. Also, South Carolina's Department of Insurance is in the same position as other state insurance departments: it is a David facing the Goliath of the insurance industry. Only 106 staff members, including the Chief Insurance Commissioner, regulate an industry which takes in billions of dollars, has national organizations and commands far greater technical capabilities.

In view of this, the Department of Insurance should not take a passive stance in monitoring the insurance industry but should be as aggressive as possible. But in reality it seldom performs studies or analyses on the insurance industry unless specifically mandated or requested by the General Assembly or the Governor.

The State of South Carolina has a need for more information about insurance. In a technical area such as insurance, which affects the lives of nearly every citizen, there is a public need to have access to easily understandable facts on insurance buying. The Department itself needs concrete, detailed studies based on hard data in order to effectively regulate insurance. The General Assembly needs objective information on the impact insurance legislation has on South Carolinians. It needs to know where the problems are and what insurance consumers need in order to legislate for the future.

South Carolina needs to know whether its insurance system is effective or ineffective, successful or unsuccessful. The only way of determining this is through research and evaluation. As Lynn L. Morris and Carol T. Fitz-Gibbon state in their procedural guide, the Evaluator's Handbook:

> "Evaluation can provide information needed for making specific decisions about a program--how to make it better, whether to keep it, throw it out, or expand it. Though it takes time, planning, and effort to collect such information, ultimately knowing what results a program or its various subcomponents are producing is the only logical basis for making effective decisions. This requires good, highly credible information." [Emphasis Added]

By its failure to effectively monitor and evaluate the insurance system, the Department of Insurance is unable to establish goals and priorities for the future. Without a comprehensive perspective on the status of insurance in South Carolina, decision-making and planning by administrators and legislators is severely hampered. The effects of proposed legislation on the system are not clearly understood or anticipated. As a result, this State has attempted to deal with insurance problems on a piecemeal basis. Thus far, any studies or recommendations made by the Department have had little effect in alleviating any problems with insurance. Until the Department adequately plans a comprehensive approach to insurance problems, it will not be in the position to help insurance consumers and effectively regulate the insurance industry.

RECOMMENDATIONS

THE DEPARTMENT OF INSURANCE SHOULD TAKE AN ORGANIZED, STRUCTURED APPROACH TO PROBLEM SOLVING. IT SHOULD IDENTIFY MAJOR AREAS OF CONCERN, DEVELOP A LIST OF PRIORITIES, AND USE A "MANAGEMENT BY OBJECTIVE" APPROACH IN SOLVING THESE PROBLEMS. THE RESULT SHOULD BE DEFINITIVE REPORTS

WITH PRACTICABLE SOLUTIONS TO INSURANCE PROBLEMS.

THE DEPARTMENT'S GOALS AND PRIORITIES SHOULD INCLUDE:

- A COMPREHENSIVE STUDY OF ACT 1177 THAT PINPOINTS ITS PROBLEMS AND STRENGTHS, ANALYZES DATA HERETOFORE COLLECTED AND COLLECTS DATA ON OTHER AREAS (E.G., AUTO INSURANCE LITIGATION), THAT THE DEPARTMENT HAS NOT YET STUDIED;

- AN ANALYSIS OF ALTERNATIVES TO THE PRESENT SYSTEM OF AUTOMOBILE INSURANCE, SUCH AS "NO FAULT" AUTOMOBILE INSURANCE;

- AN ANALYSIS OF ACCIDENT AND HEALTH INSURANCE TO DETERMINE IF BENEFITS RECEIVED BY CONSUMERS ARE REASONABLE TO THE PREMIUMS PAID;

- A SYSTEM TO MORE FULLY UTILIZE DATA ALREADY COLLECTED, SUCH AS COMPLAINT

STATISTICS, AIPSO REPORTS AND NAIC REPORTS, THAT WOULD ALLOW THE DEPARTMENT TO BETTER UNDERSTAND THE PRESENT STATE OF INSURANCE IN SOUTH CAROLINA AND MAKE ANY NECESSARY CHANGES.

Lack of Standards for Individual Accident and Health Insurance

South Carolina lacks minimum standards for individual accident and health (A&H) policies. Although these standards were mandated by law in 1975 (Section 38-35-1210, 1976 Code of Laws), the Chief Insurance Commissioner has not promulgated regulations implementing this law. Standards such as these could eliminate or at least control insurance policies which are of little benefit to the consumer. These standards would pertain to some policies that offer Medicare supplement coverage; to policies paying only a small amount, such as $10.00 a day, toward hospital costs; and to policies that offer coverage for very limited conditions, such as cancer or other "dread diseases."

Many substandard policies pay out a small amount of benefits in comparison to the premium collected. This means they experience a low loss ratio. A nationwide benchmark for an acceptable loss ratio is 50% - that means the company paid out at least 50 cents in benefits for every dollar in premium. In South Carolina for 1977, 21 of the top 50 companies writing accident and health insurance experienced loss ratios of less than 50% on individual (not group) policies.

At present there is no way the consumer can compare health insurance costs and coverage so as to make a prudent purchase. There is no standardization or "unit pricing" as there is with automobile insurance. Also, the marketplace is flooded with policies from which to choose. Analysts from the Department of Insurance estimate they approved 1,100 individual A&H policies in the last six months of 1978 alone.

Individual health policies are particularly attractive to the poor and the elderly since they usually cannot buy group insurance.

Unfortunately, the poor and elderly often find themselves on the losing side with health insurance. If they buy just one policy, they may pay a low premium but will have vastly inadequate health coverage. If they buy several policies, the result can often be duplicate coverage with a high premium cost, and still no guarantee that they have adequate coverage.

Hearings held by the U. S. Senate Committee on Aging in May 1978 revealed nationwide problems with one type of individual accident and health policy - the Medicare supplement policy. The Committee heard testimony to the effect that the elderly were wasting millions of dollars on worthless or unnecessary health coverage and that the lack of adequate State regulation has resulted in confusion, complexity and needless expense for consumers.

In 1975 the South Carolina General Assembly passed Act 253 (Section 38-35-1210 to 1270 in the 1976 Code of Laws) mandating that the Chief Insurance Commissioner promulgate regulations for minimum benefit dollar levels, disclosure of provisions and an outline of coverage for every individual accident and health policy. However, the Chief Insurance Commissioner has neglected this legislative mandate by failing to enact regulations to implement this law. The Department did propose regulations based on National Association of Insurance Commissioners' (NAIC) model regulations and a hearing was held in November 1975 to allow the insurance industry to register its comments. But more than three years after the hearing no regulations have been approved or implemented.

By mandating that these regulations be established the General Assembly sought "to provide reasonable standardization and simplification... of ordinary (individual) accident and health insurance policies...

in order to facilitate public understanding and comparison, to eliminate provisions which may be misleading or unreasonably confusing."

The regulations would have established guidelines on the minimum dollar amounts policies could offer for hospital, surgical, Major Medical and other coverages; would have set formats for wording policy provisions such as "preexisting conditions"; would have provided for a simple, explanatory outline of coverage to accompany each policy; and would have prescribed a method of identification of policies based on the coverage they provide.

Other states have set a precedent in the area of standards for accident and health policies. States with some type of standard for individual A&H policies include Massachusetts, Michigan, Florida, West Virginia, Arkansas, New York, New Mexico, California and Wisconsin. New York, New Jersey and Connecticut also prohibit the sale of "dread disease" policies.

The NAIC formulated a Model Act for minimum standards and the South Carolina law is based on that model. The NAIC also promulgated detailed regulations to implement this Act. In its lastest revision to the Model Regulations made in December 1978, the NAIC recommended adding provisions to deal specifically with policies sold to persons eligible for Medicare.

The absence of accident and health policy standards leaves the South Carolina consumer without adequate protection from substandard coverages. These types of policies often offer the consumer little or no protection while requiring a substantial premium. The consumer who buys such coverage is lulled into thinking he is fully protected, only to find at the time of a claim that he has wasted his money. Because

there is a lack of consumer information on accident and health insurance, consumers are unaware of what constitutes adequate coverage, they are confused about what their private health insurance policy(ies) and programs such as Medicare pay for, and they often end up buying non-essential or duplicate health coverage.

Inferior policies also create a climate for abuse in the marketplace. The U. S. Senate Committee on Aging found many cases where elderly consumers were defrauded of hundreds, even thousands, of dollars because they were victims of smooth-talking insurance agents selling policies of dubious value. According to Harold R. Wilde, former Commissioner of Insurance for the State of Wisconsin, their problems may be called "the mediscare insurance racket."

> Countrywide, these problems - which are the result of what amounts to an unholy alliance between the public and private sectors to confuse and exasperate the elderly of America - add up to a multi-million dollar ripoff of our senior citizens. They are nothing less than a national disgrace... Government has been and continues to be part of the problem. State regulators have too long acquiesced in practices which are morally indefensible.

The extent that these abuses exist in South Carolina is unknown. However, without regulations requiring minimum standards the risk is high. The Senate Committee received ample evidence that health insurance abuse is not confined to one or two states but is nationwide in scope and costs consumers millions of dollars. One official from the South Carolina Commission on Aging told the Council in a prepared statement that:

> Older Americans purchase policies of questionable value, multiple policies well in excess of probable need and policies offering benefits inappropriate to need [and that]... Regulations dealing in this area are dreadfully needed in South Carolina.

RECOMMENDATIONS

THE DEPARTMENT OF INSURANCE SHOULD ISSUE REGULATIONS AND ESTABLISH MINIMUM STANDARDS FOR INDIVIDUAL ACCIDENT AND HEALTH POLICIES AS MANDATED BY LAW. IN PROMULGATING THESE REGULATIONS THE DEPARTMENT SHOULD:

- DETERMINE THE HEALTH NEEDS OF CITIZENS OF THIS STATE AND SOLICIT PUBLIC INPUT INTO NEW REGULATIONS;

- REVISE THE 1975 PROPOSED REGULATIONS TO TAKE INTO ACCOUNT THE INCREASE IN HOSPITAL COSTS SINCE THAT TIME;

- TAKE INTO ACCOUNT NAIC REVISIONS TO ITS MODEL REGULATIONS AND THE COMMENTS OF THE INSURANCE INDUSTRY.

THE REGULATIONS SHOULD BE WRITTEN TO EMPHASIZE PROTECTION OF THE CONSUMER FROM INFERIOR OR WORTHLESS HEALTH COVERAGE, AND SHOULD SERVE TO SIMPLIFY POLICY FORM AND CONTENT SO INSURANCE CONSUMERS CAN KNOW EXACTLY WHAT THEY ARE BUYING.

THE DEPARTMENT SHOULD INSTITUTE A PROGRAM TO MONITOR OR REVIEW POLICIES AFTER THEY HAVE BEEN IN THE MARKETPLACE FOR SEVERAL YEARS, TO ENSURE EACH POLICY DEVELOPS AT LEAST A 50% LOSS RATIO. IF A POLICY PAYS OUT LESS THAN 50 CENTS ON THE DOLLAR, THE DEPARTMENT SHOULD ORDER IT TO BE ALTERED OR WITHDRAWN.

Lack of Regulation of Industrial Insurance

In South Carolina regulation of industrial insurance, especially industrial life insurance is inadequate. Industrial insurance is sold door-to-door by an agent who also collects the premiums weekly from his policyholders. The most widely-sold form of industrial insurance is life insurance, usually policies with a face amount of under $5,000 and a small weekly premium. Some accident, health and fire insurance also are sold under the weekly payment system. In addition, a great deal of life insurance, usually called "monthly debit ordinary," is sold on a similar basis except the agent collects the premiums monthly.

Direct written premiums for industrial life insurance in South Carolina in 1977 totaled $52,952,367 (this figure does not include premiums for monthly debit ordinary). Total industrial life insurance in force in South Carolina as of December 31, 1977, was approximately $898,154,710. However, this substantial segment of the life insurance industry is not adequately controlled by the law.

Presently, many of South Carolina's laws designed to protect the buyer of ordinary life insurance have special exclusions for industrial insurance. For example, the statutes exclude industrial insurance from the requirement that the application be made part of the whole insurance contract (S. C. 1976 Code of Laws, Title 38, Chapter 9, Section 70). Also, South Carolina statutes allow cash values to be delayed until the industrial life policy has been in force for five years; with ordinary insurance, the cash values must begin after three years (Title 38, Chapter 7). Two of the most important consumer protection regulations in this State, "Solicitation of Life Insurance" and "Replacement of Life Insurance," do not offer equal protection for policies that have face values under $5,000.

The Department of Insurance traditionally has let competition in the marketplace regulate most aspects of life insurance. But, even if the Department were to focus its attention on industrial insurance, it would lack the data necessary for regulation. While the Department does collect some data on industrial (weekly) life insurance, data on monthly debit insurance is buried within the aggregate reporting for all life insurance business. No data at all exists on the amount of accident and health insurance sold on an industrial or debit basis. Thus, it is difficult to know to what extent industrial and debit insurance is sold in this State; what its profits, sales expenses and benefits are and how they compare with ordinary lines of insurance. In short, the lack of separate reporting for all industrial and debit insurance shelters this type of insurance from oversight and regulation.

Industrial insurance finds its largest marketplace among low-income groups primarily in the Southeast, according to the Federal Trade Commission (FTC) report, "Life Insurance Sold to the Poor: Industrial and Other Debit Insurance." The FTC report, based on a two-year study of life insurance, is very critical of industrial insurance and the methods used to sell it. Industrial insurance consumers are often illiterate and rarely understand the product they are buying. In fact, life insurance customers in general have trouble understanding complicated insurance policies and plans and are ill-equipped to assess life insurance in terms of its benefits and costs. When consumers are incapable of judging the relative merits of a product for themselves, government intervention is needed.

The lack of consumer buying guides for industrial insurance consumers, the high unit price of this insurance and the agent marketing

system helps create a climate for abuse. Federal authorities have begun to take a critical look at industrial life insurance. The Senate Anti-trust and Monopoly Subcommittee opened hearings on industrial and debit insurance in March of this year. Chairman Howard Metzenbaum (D-Ohio) called industrial insurance "an area in which abuse is so severe that it raises fundamental questions about the efficacy of State regulation."

As a result of inadequate State regulation, consumer problems associated with industrial insurance have received little attention. These consumer problems fall into two areas: low value products and abusive marketing practices.

Industrial life insurance can be a low value product because it costs more per $1,000 of coverage than insurance sold on an ordinary basis. According to a shopper's guide published by the Pennsylvania Department of Insurance, an industrial life insurance policy sold by a South Carolina-based company costs $23.72 per $1,000 of face coverage per year over ten years. This compares to a $10,000 straight life policy which costs $4.50 per $1,000 per year over ten years. There are several reasons why industrial life is so expensive:

(1) The marketing system necessitates a high sales expense, which the consumer's premium dollar must pay for.

(2) Insurance costs more if sold in small amounts than it does when sold in large or "bulk" amounts.

(3) Industrial life insurance companies are allowed to set rates by pessimistic mortality tables (the assumption being that poor people die earlier). This raises individual rates. These tables are dated 1961; there is no proof that they are valid today.

Agent abuse is another problem. The FTC report accused industrial insurance agents of overselling customers, causing them to buy

more policies than they could afford and subsequently lapsing the insurance. While the agent can then resell the lapsed policy to the customer and gain a large sales commission, the customer loses money if a policy is lapsed shortly after it is purchased.

The commission structure encourages agents to sell as much insurance as possible. At the same time, the only source of information about life insurance for the typical industrial customer is the agent - who is trying to sell as much as possible. There is no guarantee that these agents have much expertise in the field of insurance. Often agents who sell these policies are temporary agents, which means they have not yet taken and passed the Department of Insurance's licensing examination. Department of Insurance data shows that eight industrial life insurance companies, including the largest in South Carolina, employed more than 500 temporary agents in 1977. The FTC report listed several cases where impoverished customers were paying a good part of their weekly income to keep all their life insurance policies in force. The report also accused industrial insurance agents of outright fraud and misrepresentation. The extent of such abuses in South Carolina is unknown. However, one former industrial insurance agent in South Carolina told the Council that he was encouraged to "sell people a fast pitch," and even to falsify policyholders' payment records if he could get away with it.

RECOMMENDATIONS

THE DEPARTMENT OF INSURANCE SHOULD BEGIN AN INTENSIVE CONSUMER INFORMATION CAMPAIGN AIMED ESPECIALLY AT POTENTIAL INDUSTRIAL

INSURANCE CONSUMERS, ON HOW TO BUY LIFE INSURANCE AND WHAT ALTERNATIVES THERE ARE TO INDUSTRIAL INSURANCE.

THE DEPARTMENT SHOULD WORK TO REVISE STATUTES AND REGULATIONS SO AS TO AFFORD INDUSTRIAL INSURANCE CONSUMERS THE SAME PROTECTION AS OTHER INSURANCE CONSUMERS.

THE DEPARTMENT SHOULD DEVELOP AND THEN RECOMMEND MEASURES THAT WILL IMPROVE THE QUALITY AND PRICE OF INDUSTRIAL INSURANCE.

THE DEPARTMENT SHOULD TAKE STEPS TO REDUCE THE INAPPROPRIATE SALE OF INDUSTRIAL INSURANCE.

THE DEPARTMENT SHOULD HELP DEVELOP ALTERNATIVES TO INDUSTRIAL INSURANCE FOR LOW-INCOME PEOPLE. SUCH ALTERNATIVES COULD INCLUDE:

(1) SAVINGS BANK INSURANCE LIKE THAT SOLD IN NEW YORK, CONNECTICUT AND MASSACHUSETTS.

(2) A STATE LIFE INSURANCE FUND SUCH AS THAT USED IN WISCONSIN.

(3) ENSURING THAT LOW-INCOME PEOPLE, MINORITIES AND THE AGED HAVE FAIR AND EQUAL ACCESS TO ORDINARY LIFE INSURANCE.

Inadequate Consumer Protection and Assistance

A major responsibility of any regulatory agency is the protection of the consumer in the marketplace. The Council examined the Department's efforts in this area and found that improvements are needed. Although current programs do assist consumers after they have insurance difficulties, the Department is not active in detecting and preventing unfair market practices, sales and claims handling.

The Council identified four areas which indicate an overall lack of program design, initiative, and oversight in the marketplace by the Department. These are:

(1) Lack of field investigations.

(2) Limited public accessibility to the Department's consumer assistants.

(3) A scarcity of public information programs on insurance.

(4) Lack of public information on the conduct of insurance companies.

(1) Lack of Field Investigations

The Department does not have an aggressive program designed to detect unfair marketing practices and claims handling. During FY 77-78, 55 investigations were conducted in the marketplace by one full-time and one part-time investigator. These investigations were initiated either after two or more formal complaints on an agent or company or after an inquiry by another division in the Department. In addition, 20 investigations were made of designated agents.

The 55 investigations were in the following areas:

Misuse of Premiums	22
Unlicensed Soliciting or Selling of Insurance	7
Misrepresentation or Fraud	16
Improper Claims Handling	3
Investigation of Agent's Criminal Record	7
Total Investigations	55

Sales tactics that are misleading, coercive, or fraudulent are specifically prohibited by the Trade Practices Act (Section 38, Chapter 55, 1976 S. C. Code of Laws). Unfair claims practices are specifically forbidden by Section 38-37-1110 to 1130. Currently the Department has no way to actively enforce these laws. Even when other states discover companies are using questionable or fraudulent practices they are not followed up in South Carolina. While most companies and agents sell their product in a reputable manner, the Department has no effective method of detecting those who do not.

The Department has only one full-time and one part-time investigator plus a section chief who spends approximately 20% of his time on investigations. These men must also do other investigations which are not involved in consumer complaints such as checking on an agent's background for the Licensing Division. The lack of a fully staffed and aggressive investigation unit illustrates the absence of a regulatory presence at the consumer level in a marketplace of 1,001 companies and more than 21,000 agents.

(2) Limited Public Accessibility to the Department's Consumer Assistants

The consumer complaint services provided by the Department's Market Conduct Division are not easily accessible to the majority of the citizens of the State. Currently a person with a complaint who is not in the Columbia metropolitan area must either correspond by mail or place a long distance telephone call to the Department. This is inconvenient to the majority of the State's population. Other states and state agencies which provide similar complaint services have found that the use of a toll free number greatly increases their ability to respond quickly to inquiries and complaints on a statewide basis at a relatively low cost. The Audit Council sampled 300 insurance complaints of the more than 3,000 recorded in 1978, and found that 82% of complaints came from persons outside of the Columbia metropolitan area. Thus a majority of the persons filing complaints would have benefited from this service.

In addition, most members of the public are not aware of the existence of the Department's complaint services. In a Council survey mailed randomly to the general public, 42% of the 120 respondents stated they were not aware the Department of Insurance existed. Seventy-two percent (72%) stated they were not aware of the Department's ability to handle consumer complaints. While the Department was told in 1975 by the Consumer Affairs Department that a toll-free number was an excellent way for the public to reach an agency, it rejected the idea as too expensive.

(3) A Scarcity of Public Information Programs

Until the last few months the Insurance Department lacked any programs for providing information to the general public on insurance. In January 1979 the Department published a booklet on automobile insurance for consumers. It also has implemented a regulation requiring life insurance companies to provide consumers with information that will enable the consumer to determine his own insurance needs and to make comparisons of available insurance policies.

This is a step in the right direction, however, there is still a consumer need for information on all lines of insurance. Forty-one percent (41%) of the citizens answering the Council's questionnaire said they had either a poor understanding or no understanding at all of commonly used insurance terms. On another question 53% of the respondents stated they did not understand the benefits and coverages of their insurance policy(ies). Eighty-two percent (82%) of the people answering these surveys said they would benefit from a series of informative booklets about insurance.

(4) Lack of Public Information on the Conduct of Insurance Companies

The Department does not provide the public with information regarding the performance of a company in the marketplace as reflected by the number and type of complaints received at the Department. The Department has determined that some companies have a greater number of complaints than other companies when compared to their volume of business. The Department, however, does not widely publicize this information.

This lack of consumer oriented programs is due to a lack of policy direction by the Department and a low priority for funding and staffing in these areas. The Department's responsibility for consumer assistance is thus not being met and unfair market practices and claims handling are not being detected.

It is the Department's responsibility to protect the consumer, to provide consumer assistance and to provide as much information to the consumer as possible. The 1975 McKinsey and Company study of the Insurance Department specified several programs the Department should institute in order to aid the consumer. These included the staffing of an investigation unit and the establishment of a toll free number for complaints. At this time the investigations unit is severely understaffed and there is no toll-free number.

The McKinsey report specified that there should be one investigator for every $400 million in premium volume in the State. Based on this standard, South Carolina would need a minimum of four investigators. Without active and aggressive investigations the marketplace cannot be adequately policed.

It is the stated policy of the Insurance Commission that the Market Conduct Division should protect consumers "through detection of unfair market practices... (and) regular field examinations," (emphasis added), as opposed to becoming involved after a complaint has resulted. There are several statutes and regulations designed to protect the consumer yet the Department simply lacks the manpower to actively enforce them.

In addition to market investigations other states and state agencies have found that there are a multitude of programs which can be used to

aid consumers, such as a toll-free telephone number and providing the public with information in order to make better decisions in the marketplace. Both Michigan and Illinois distribute fact sheets and detailed booklets on how to buy auto, life and health insurance, how to make claims properly, how to decrease premium payments, how new insurance laws will affect the public and summaries on the performance of the insurance system.

On the Federal level, the House Interstate and Foreign Commerce Committee has recently issued a report on life insurance. The report concludes that consumers lack information to buy insurance wisely and that "significant consumer loss occurs" because consumers buy unwisely.

Other states which compile complaint information against companies have decided that the public has a right to have access to this information. Illinois, for example, has begun a "crackdown" on auto insurance companies with high levels of complaints. An October 1978 news release quotes the Illinois Insurance Director as saying:

> "We are sick and tired of the extremely high complaint levels against some insurers...The Department won't tolerate behavior by any auto insurer that exhibits contempt for its own policyholders and claimants...Our objective is to have every Illinois driver served by a reasonable, fair and businesslike insurance company."

Illinois also has begun a program of detailed investigation of files and records of all companies with high complaint rates as well as requiring companies to respond to complaints within a reasonable amount of time.

The absence of these types of consumer programs and the lack of aggressiveness by the Department in the marketplace means the consumer is not adequately protected. The limited effectiveness of the

Market Conduct Division indicates the Department is not meeting its objective of ensuring consumer protection against unfair market practices and claims handling. Not only will marketplace abuses go undetected, but consumers will continue to be uninformed about insurance, which has an increasingly important effect on their lives.

RECOMMENDATIONS

THE DEPARTMENT SHOULD STAFF ITS INVESTIGATIONS UNIT WITH AT LEAST FOUR FULL-TIME PROFESSIONAL INVESTIGATORS.

A TOLL-FREE NUMBER SHOULD BE ESTABLISHED IN ORDER TO RESPOND TO PUBLIC COMPLAINTS.

THE DIVISION SHOULD USE THE NEWS AND OTHER MEDIA IN ORDER TO INFORM THE PUBLIC OF ITS CAPABILITY TO AID IN CONSUMER COMPLAINTS AND OTHER SERVICES.

THE DIVISION SHOULD CONTINUE TO ISSUE INFORMATIVE BOOKLETS AND FACT SHEETS ABOUT INSURANCE, THE PURCHASE OF INSURANCE AND THE SOUTH CAROLINA INSURANCE SYSTEM.

THE DIVISION SHOULD PUBLICLY RELEASE ALL STATISTICS REGARDING THE NUMBER AND TYPE

OF COMPLAINTS AGAINST COMPANIES AND OTHER INDICATIONS OF MARKET CONDUCT ON A REGULAR BASIS.

Violation of State Law Concerning Travel Reimbursement

Financial examiners of the South Carolina Insurance Department are being reimbursed for travel expenses at a rate different from that authorized for State employees by the 1978-79 Appropriation Act. This is a violation of State law. The current practice is for these examiners to be reimbursed directly by the insurance company being examined. A flat fee of $35 per day is paid for subsistence during out-of-state examinations and $25 per day is paid during in-state examinations. Also, a mileage allowance of 17¢ per mile is paid for the use of the examiner's personal automobile.

The South Carolina Insurance Commission, at the recommendation of the Chief Insurance Commissioner, approved the current rate of reimbursement at a February 5, 1976 Commission meeting after these rates were suggested, in guideline form, by the NAIC. When asked how long this policy of direct reimbursement had been in effect, Department officials responded that it was a "tradition" that went back further than they could remember. Inspection of Department memoranda indicated that this policy is at least ten years old.

Section 136 of the 1978-79 Appropriation Act states:

> Travel and subsistence expenses, whether paid from State appropriated, Federal or other funds, shall be allowed in accordance with the following provisions:
>
> All employees of the State of South Carolina or any agency thereof while traveling on the business of the State shall, upon presentation of a paid receipt, be allowed reimbursement for actual expenses incurred for lodging. The employee shall also be reimbursed for the actual expenses incurred in the obtaining of meals except that such costs shall not exceed $12 per day, except in urban area outside of South Carolina with populations in excess of 250,000, in which case the maximum daily reimbursement for meals shall not exceed $15.

> When an employee of the State shall use his or her personal automobile in traveling on necessary official business, a charge of 16¢ per mile will be allowed for the use of such automobile and the employee shall bear the expense of supplies and upkeep thereof.

Section 131 of the same Act also states:

> ...Provided, Further, That the expenditure of funds by agencies of the State Government from sources other than General Fund appropriations shall be subject to the same limitations and provisions of law applicable to the expenditure of appropriated funds with respect to salaries, wages or other compensation, travel expense, and other allowances or benefits for employees.

By reimbursing examiners at a rate other than that allowed by South Carolina law, an inequitable situation is created. Over the past several years examiners have been reimbursed at rates both higher and lower than allowed by law for other State employees. In FY 77-78 and in the current year a financial examiner may have received less in total reimbursements for travel than other State employees in comparable situations. An examiner conducting an out-of-state examination now receives $35 a day to cover lodging and meals plus 17¢ a mile for use of his personal automobile on official business. Another State employee under comparable conditions would be reimbursed the actual cost of the lodging, $12 to $15 a day for meals depending on the population of the city in which he is staying and 16¢ per mile for use of his personal automobile. If the person's lodging cost more than $20 a day, which is likely in a large metropolitan area, then the examiner received less than he was entitled. However, up until FY 77-78 examiners were being reimbursed more than other State employees. In FY 75-76 and FY 76-77, South Carolina law specified that State employees on official business to urban areas with populations of 250,000 or greater could be reimbursed

up to $30 a day and 14¢ a mile for use of a personal automobile. At the same time Department examiners were receiving $5 a day and 3¢ a mile more than other State employees as allowed by law.

Questionable Method of Payment

The South Carolina State Auditor, in a mangement letter sent to the Insurance Commission and the Department of Insurance in September of 1978, disapproved of the method of companies directly reimbursing examiners for travel expenses. This report stated that it preempted the Commission's control over actual payments and could "somewhat impair" the independence of the examiners. The State Auditor recommended that companies be requested to make payment to the State and examiners be required to submit travel vouchers to the agency for reimbursement of expenses incurred.

The Chief Insurance Commissioner, in a reply sent to the State Auditor on September 27, 1978 did not completely agree with the recommendation but stated that the Department "would agree to mailing the expense check to the South Carolina Insurance Department for review and approval here before transmittal to the examiner." However, as of this date the Department has not followed this action.

RECOMMENDATION

THE INSURANCE COMMISSION SHOULD REIMBURSE EXAMINERS IN ACCORDANCE WITH SOUTH CAROLINA LAW.

Need For Continuing Education Requirements for Insurance Agents

Insurance agents in South Carolina do not have to meet any educational requirement other than passing a Department of Insurance test in order to obtain a license. An agent does not even need a high school diploma to be licensed. There is no stipulation that an agent acquire comprehensive knowledge of his particular field either prior to or after he or she has become licensed.

Although department officials have indicated that they favor continuing education requirements for agents, the department has taken no official position on this topic - nor has the department made any legislative recommendations concerning agents' education.

Other states have laws or regulations that require agents to continue their education in insurance. A 1977 Kentucky study identified 11 eastern states which require prior and continuing education to a various degree for agents. Virginia, for example, requires all prospective agents to complete ninety classroom hours approved by the insurance commissioner before they can obtain a license. Florida requires completion of approved course work by agents within two years of application for licensing. Georgia has similar requirements.

The concept of continuing education has also received the attention of the National Association of Insurance Commissioners (NAIC). In 1978, the NAIC Continuing Education Task Force submitted model legislation in order to aid states in establishing guidelines and standards for continuing education programs. This model legislation recommended minimum and maximum classroom hours, standards for compliance and suggested penalties for non-compliance.

Due to the increased necessity of insurance, complicated insurance contracts and consumer reliance on insurance agents for advice, there is a need to assure the public that agents are as competent as possible. As stated in Johnson v. Independent Life, etc., Ins. Co., (94F Supp 959 1951) "the paramount purpose of ...S. C. Code concerning insurance agents... is to safeguard the interests of policyholders by ascertaining that the agents through whom they deal are competent and trustworthy." (Emphasis Added)

Continuing education is the one means to ensure the level of agent competency needed to adequately serve policyholders. A Council survey of insurance companies indicates that 75% of those companies responding provide continuing education courses for their agents. However, a survey of insurance agents shows that only 33% use continuing education opportunities. Mandatory education requirements would help maintain agent competency, provide better service to policyholders, and upgrade the professional status of insurance agents. For these reasons, mandatory continuing education is supported by a local South Carolina agents' association.

Currently, insurance agents only have to demonstrate they are capable of passing a multiple choice test. The lack of educational requirements puts the burden of guaranteeing agent competency on the insurance companies, not the Department. It is assumed that the reputable companies will hire prospective agents carefully to ensure a high level of integrity and competency. However, the high turnover of agents indicates this is not always so. In cases where the insurance company fails to carefully screen its agents before hiring, there is nothing between the unwary consumer and the incompetent agent other than the Department examination.

The examination may demonstrate an agent's rudimentary knowledge of his field but does not ensure that an agent is competent. Agent incompetence ultimately is detrimental to the insurance industry and all South Carolina consumers.

RECOMMENDATIONS

LEGISLATION SHOULD BE PASSED REQUIRING MINIMUM TRAINING STANDARDS PRIOR TO AND AFTER OBTAINING A LICENSE TO CONDUCT BUSINESS AS AN INSURANCE AGENT IN SOUTH CAROLINA. SUCH LEGISLATION SHOULD INCLUDE:

(1) MINIMUM NUMBER OF INSURANCE COURSE HOURS REQUIRED PRIOR TO LICENSING AS AN AGENT;

(2) MINIMUM NUMBER OF INSURANCE COURSE HOURS REQUIRED EACH YEAR FOR LICENSED AGENTS;

(3) STIPULATION THAT ONLY THOSE COURSES APPROVED BY THE INSURANCE COMMISSION SHALL APPLY TOWARD AGENT LICENSING OR RELICENSING;

(4) THE DIVISION OF AGENTS LICENSING SHOULD REVIEW AND VERIFY EACH AGENT'S COURSEWORK

DOCUMENTATION PRIOR TO ISSUING OR REISSUING LICENSE TO SELL INSURANCE;

(5) ANY AGENT OR APPLICANT WHO HAS NOT FULFILLED MINIMUM EDUCATIONAL REQUIREMENTS AS SET FORTH SHALL NOT BE ISSUED A LICENSE TO SELL INSURANCE.

Ratemaking

One of the most visible and probably most controversial functions of any regulatory agency is ratemaking. South Carolina operates on a "prior-approval" rating system. This means that property and casualty insurance rate changes must be approved before they can be used. The Chief Insurance Commissioner has the authority to approve rate changes after he reviews the rate filing with the Insurance Commission.

Homeowners and automobile insurance are the two major types of property and casualty insurance regulated, and these two lines affect the majority of the population. By law it is the responsibility of the Chief Insurance Commissioner to ensure that rates are "adequate, not excessive nor unfairly discriminatory" (Section 38, Chapters 37 and 43, 1976 Code of Laws). The Council reviewed the Department's ratemaking procedures and the methods used in analyzing property and casualty rate filings and determined them to be fair and objective. The following is a description of those procedures and the method used to analyze rate change requests.

Ratemaking Procedures and Analysis

The Department's property and casualty actuary plays a central role in reviewing and analyzing rate requests. The actuary must verify data submitted by companies when they request a rate increase and devise a mathematical formula to predict the company's future losses and income. It is his recommendation to approve, disapprove or alter the rate request which is a major factor in the Commissioner's decision on the rate filing. The Commissioner and with the members of the Insurance Commission also consider "social" factors such as the impact a rate increase would have on the marketplace.

By law, the property and casualty lines of insurance can only be granted one rate increase in a year. Procedures for rate filing are set by statute and Department policy. The Department has 60 days to respond to a property and casualty rate filing; if no action is taken by that time the company is free to use the new rate. The Department can gain more time simply by requesting the company to provide additional information. The whole rate review process can take from one month to several months depending on the impact of the rate increase, the company's promptness in providing requested data, and whether or not the Department's decision is challenged in court.

When a company files a rate request it must submit data showing its losses, premiums, expenses and profits for at least the past three years. The actuary, along with his staff, verifies these figures by matching them against statistical reports provided by the NAIC, AIPSO and the company's own annual statement. The actuary then performs his independent analysis of the data.

The basic formula for devising rates is simple. A company's losses and expenses are added together and that figure is compared with its premium income. This computation, however, only tells what the company should have been charging in the past. In order to predict future losses and the premiums needed, the actuary must devise a mathematical formula based on past trends. He also takes into account trends such as the rate of inflation or the increase in accidents, and public policy such as President Carter's request to hold price increases at 7% annually.

If the company requesting a rate change (whether an increase or decrease) writes more than $500,000 in premiums yearly, a public hearing must be held. The Chief Insurance Commissioner or his designate is

the presiding officer of the hearing. The actuary and the chief general counsel represent the Department. The third party is the company requesting the rate change. The public is invited and notice of the hearing must be published in major newspapers around the State. As of December 1978 the Consumer Advocate of the Department of Consumer Affairs has been present to represent the public. The hearings are held in accordance with the State Administrative Procedures Act (Act 176 of 1977).

After the public hearing the Department's Rate Review Committee consisting of the Deputy Chief Insurance Commissioner, the actuary and other staff members meet to discuss the rate filing. At this time a recommendation is made to the Chief Insurance Commissioner whether to approve, disapprove or alter the rate filing.

Based on this recommendation the Chief Insurance Commissioner makes his decision on the rate change request. The Department's practice has been to review this decision with the Commission although the Commission can only "concur" or "non-concur" with the Commissioner's recommendation. The Council's examination of the monthly Commission meetings over the last three years found they had never disagreed with the Commissioner's decision.

Since January 1, 1975 to January 1, 1979, the Department granted 209 rate increases for auto insurance companies. Sixty-two of these increases were for major insurance companies and required rate hearings. In 1978, the Department approved 12 private passenger auto insurance rate increases which are expected to generate more than a $20.5 million increase in premiums. It approved nine major homeowners and mobile

home insurance filings for an overall total premium increase of $1,733,258. Five commercial auto rate increases were approved in 1978 for a dollar impact of at least $2,934,870.

Other Management Areas

During its review of the Department of Insurance, the Legislative Audit Council examined its functions closely. Many hours of staff interviews were conducted; departmental records, reports, statistical analyses and work methods were studied. The Council found, overall, a capable staff performing their work on an adequate and efficient level. However, there are some areas where improvements could be made. These problems are outlined in the paragraphs below along with the Council's conclusions.

(1) Property Control

The Council tested the effectiveness of property control by the administration division, which maintains a 1,000 item inventory for the entire Department. Sample items were drawn from the computerized agency inventory printout, and identified, located and verified by the Council. Spot checks of items in various Department offices were conducted as well.

Conclusion

The Council is satisfied Department property control follows State regulations and all reasonable efforts have been made to protect State property. However, increased consolidation and coordination of inventory records would serve as a cross-reference to the agency printout and give the Department an extra measure of control.

(2) Procurement

The Insurance Department follows purchasing policies and procedures as outlined by the manual published by the Budget and Control Board's Division of General Services. Examination of sample vouchers indicated apparent adequacy, efficiency, control, and compliance with procurement-related activities.

Conclusion

The Council questions the purchase of a $1,200 Sony Video Cassette system which was obtained in September 1975. The system was to provide educational and instructional programs for analysts of the Financial Condition Division. Only one set of five cassettes has been used over the past three years, benefitting just three financial analysts who were hired since the purchase. This equipment is underutilized and the Council doubts the intended use of the system has justified its cost.

(3) Travel

The Department of Insurance spent $44,452 for travel in FY 77-78, half of which was expended by the Administrative Division. Reimbursement of mileage, meals, lodging and the payment of per diem allowances is outlined by the Comptroller General in the Code and Classification manual. The Council reviewed travel-related vouchers for accuracy, authorization, proper rate application and documentation. The following irregularities were noted:

(1) A case where an employee's car was taken on an extended out-of-state trip when the air fare was less expensive.

(2) Cases where employees stayed in private accomodations on out-of-town trips and claimed their entire $25 allowance for meals.

(3) Reimbursement for excessive "porterage."

(4) A case where a travel agency charged the Department first-class air fare for coach seats. (The Council secured a $44 refund for the Department.)

(5) Insurance companies are reimbursing Financial Condition Examiners' travel expenses at rates other than those outlined by State law (see p.).

The Council further noted that several complaints against the Department of Insurance have been lodged with the Division of Motor Vehicle Management (DMVM) concerning violations of State

automobile policies. The violations included a speeding incident to which the Chief Insurance Commissioner responded, "the driver of the vehicle was a Constable proceeding in the course of a law enforcement mission involving a criminal violaton of the laws of the State of South Carolina." Also noted were cases of unauthorized use of State vehicles and a case of reckless driving where "the driver was in an exceptional hurry to return to the offices of the Insurance Department from an official business run."

Conclusion

The hazardous operation of automobiles is neither lawful nor consistent with the mission of the Department of Insurance. Increased diligence in monitoring travel-related expenses and motor vehicle usage is strongly recommended to the Department.

(4) Training and Procedures Manuals

Most divisions lack training and procedures manuals and new employees receive most of their instruction from senior staff members on the job. Almost 25% of the professional staff is over 50 years of age and the average age of Market Conduct Division employees is 54. This indicates a large number of retirements will occur over the next few years.

Conclusion

The Council recommends that all divisions but especially the Market Conduct Division develop detailed training and procedures manuals.

(5) Market Conduct Division

The Market Conduct Division does not share complaint reports with other Department divisions in a way which fully uses the information gathered. For example, while the Market Conduct

Division compiles statistics on the number and type of complaints and the companies involved, this information is of little use to the Forms and Rates section, which also helps protect the consumer by making sure policy forms comply with the law. The Forms and Rates section has no way of knowing if a consumer complaint was caused by an insurance policy that they approved.

Other divisions also spend a great deal of time answering technical questions involved in consumer complaints. This has taken away from their own responsibilities.

Conclusion

There is a need for more coordination between the Market Conduct Division and other divisions in the Department. A system to coordinate the work between these divisions would make the Department more effective in meeting the needs of the marketplace. Since Market Conduct has the most direct contact with the marketplace, it should regularly communicate consumers' needs and problems to the other divisions. It also should develop the expertise to handle inquiries from the public without burdening the analysts in other divisions. Only the more complex questions should be reserved for the other technicians.

(6) Penalties for Agents

When an agent is found guilty of violating State law or regulations, the only disciplinary mechanism available to the Department is to revoke the agent's license. This can result in a reluctance on the part of insurance companies to report agent violations, and reluctance on the part of the Department to pursue these agents.

Conclusion

Legislation should be passed that allows the Department to issue a regulation, subject to the approval of the General Assembly, that agents guilty of minor violations may be punished with a fine.

(7) Advertising

Although the Department has issued a regulation establishing minimum standards for the advertising of accident and health insurance, it has no method for enforcing this regulation. The regulation prohibits deceptive words and phrases and seeks to assure truthful and adequate disclosure of all material and relevant information in health insurance advertising.

No division in the Department has been given the authority and the staff necessary to enforce this regulation by regularly examining advertising material. The Forms and Rates section will analyze ad material if a company submits it along with a policy form for approval; Market Conduct assistants also will examine advertising when it is brought to their attention. However, no division is consistently reviewing companies' advertising methods.

Conclusion

The Department should assign responsibility and staff for review of accident and health insurance advertising.

(8) Accident and Health Insurance Rate Filings Backlog

The Department has allowed a backlog of rate filings for accident and health insurance to develop. As of January 1, 1979 there were 362 rate filings pending. More than 100 of these filings were several months old, some dated as far back as September 1977. Most of the pending filings were more than a month old.

Since the Department has, by statute, only thirty days to take action on a health insurance rate filing, insurance companies have the legal right to use the requested rate whether or not it

has been approved. This would circumvent the intent of the rate approval process which is a vital function of the Department. Also, it can mean companies are putting rates into effect which may prove to be excessive. Recently an analyst has been given the duty of disposing with the backlog of rate filings.

Conclusion

The Department should continue to work to dispose of the rate filing backlogs and take the necessary steps to ensure that the problem doesn't develop again in the future.

(8) Underwriting Audits

Until recently, the Department of Insurance had conducted only three underwriting audits of automobile insurance companies in the past ten years. These audits would examine auto insurance companies to make sure they are correctly classifying drivers, obtaining yearly motor vehicle records and are following the mandate to sell insurance to anyone who wants it (see Chapter 3, p.). The audits also would examine companies' claims and loss adjustment practices.

Conclusion

The Auto Rating section should undertake more audits of companies. The aim of the audits should be to ensure better treatment of policyholders, enforcing the rating classification plans and to help companies better control their own losses.

(9) Auto Insurance Form and Rate Filings

Currently an auto insurance company must receive approval for every change in the rates, forms and rules it uses, even when the company does a small volume of business. Auto insurance

analysts told the Council much of their time is taken up by "echo" filings. These are filings by a small company that copies rate bureau filings already approved. From January 1975 to February 1979, the Department approved 150 "small" filings (those which do not require a public hearing). One hundred and eight (108) of these filings were only to copy bureau rates already approved.

Conclusion

While the Department may wish to retain prior approval over every auto insurance rate filing, it is an inefficient use of a regulator's time to have to review every small change in a company's forms or rules. The Department should initiate a "file and use" system for automobile forms and rules, thus freeing analysts to concentrate on major problem areas.

(10) Ratemaking - Expense Component

The traditional way of computing auto insurance company expense costs has been to figure them as a percentage of the total premiums earned. Most companies, for example, list expenses as approximately 25% to 30% of the premiums earned. This means that policyholders who pay a higher auto insurance premium also contribute more money toward company expenses.

Company expenses are composed of three components: sales expenses, general overhead, and the cost of assessing and settling claims. Some of these expenses, like claim adjustment expenses, may vary in proportion to the size of the premium but costs such as company overhead do not vary according to the policyholder and the price paid for insurance. It is erroneous to assume that a policyholder who must pay 25% more in premiums because he is a higher risk, also costs the company exactly 25% more in expenses.

Conclusion

The Department of Insurance should develop a ratemaking method that examines expenses separately from losses. Expenses should not be presumed to change in the same proportion that loss costs change. Each component - expenses and losses - should be trended separately. Also, certain expenses should not be figured as a percentage of each in insurance policy premium, but should be assessed as a flat fee equally among policyholders. Then all auto insurance companies should be ordered to comply with this method in their rate filings.

CHAPTER 3

SOUTH CAROLINA'S AUTOMOBILE INSURANCE SYSTEM

Introduction

An effective insurance system depends not only on the efficiency and quality of regulation but also on the type of insurance system mandated by law. This is especially true in the area of automobile insurance. In following the mandate to review and evaluate the programs which the agency is responsible for administering the Council reviewed the automobile insurance system in detail. This was done primarily because auto insurance is compulsory and affects the majority of citizens in the State. Also, it is more heavily regulated than any other type of insurance and a large portion of the Department's efforts are concentrated in this area. In addition, because of the number of vehicles, the ability of the automobile to cause major losses and the numerous methods employed by the insurance industry to control these losses, automobile insurance is the most visible and controversial type of insurance.

This chapter will analyze South Carolina's automobile insurance system and assess its strengths and weaknesses. Included will be a review of the specific market mechanisms established under the most recent major auto insurance legislation, Act 1177 of 1974. Also, problem areas in the automobile insurance system identified by the Audit Council will be presented along with possible solutions.

Background and History

South Carolina's automobile insurance system has come under strong criticism over the last several years from both the consumer and the insurance industry. The pressures to keep automobile insurance premiums low and at the same time provide more and more benefits to accident victims constantly cause problems. Increasing insurance premiums are a hardship on many people who by law are forced to buy insurance. Affordable insurance is quickly becoming one of the most critical problems affecting the automobile insurance system in South Carolina.

Nationwide, the cost of auto insurance has risen 115% since 1967 while the cost of living has risen 102.9%. Auto insurance premiums has barely kept pace with the increasing prices for the items auto insurance pays for: medical care and car repair. Since 1974 the consumer price index has risen 55.2% and auto insurance premiums 76.9% while hospital charges, physicians' fees and auto repair have risen 129.4%, 57.5%, and 63.4% respectively. The following table illustrates how inflation has affected insurance and the items insurance pays for.

TABLE

PRICE INDICES FOR SELECTED ITEMS, 1967-78

Year	Cost of Living	Hospital Charges	Physicians' Fees	Auto Repair & Maintenance	Auto Insurance Premiums
1967	100.0	100.0	100.0	100.0	100.0
1974	147.7	201.5	150.9	156.8	138.1
1978	202.9	330.9	208.4	220.2	215.0

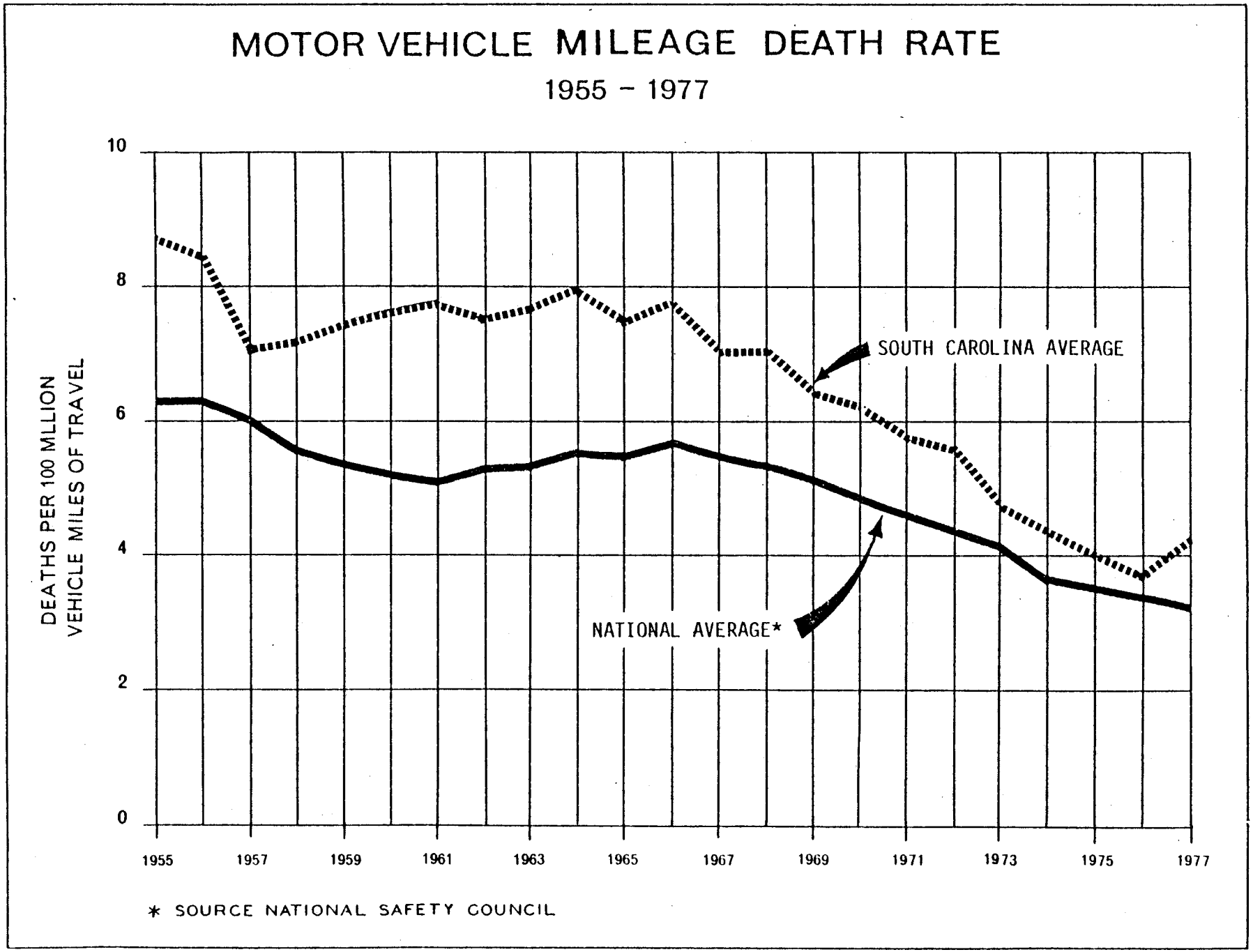
Source: U. S. Department of Labor, Bureau of Labor Statistics.

The current increase in the cost of automobile insurance severly affects a majority of South Carolinians. In 1977, 66.7% of the families had adjusted gross incomes of $10,000 or less. In 1978, a one car family with two adult drivers living in Columbia would have paid $351 for the minimum coverages required by law, with collision and comprehensive insurance. If this family had a 17 year old son on the policy, the rate rose to $499 (all rates are Insurance Services Office rates). If this family made no more than $10,000 a year, they spent 3.5% to 5% of their income on car insurance. For the majority of families with incomes under $10,000 even a greater proportion of their income went for car insurance.

South Carolinians have more and costlier accidents. The number of reportable accidents increased 75.2% in the ten years from 1968-1977 while the number of licensed drivers only increased 30.8%. South Carolina has the highest rates of automobile accident deaths per 100,000 population and ranks 7th in the nation. In 1977, South Carolina's motor vehicle death rate was 36.6 per 100,000 population compared to the national average of 22.7. The death rate per 100 million miles of travel was 4.2 compared to the national average of 3.3 (see graph 1).

In 1977 South Carolina had 91,485 reportable accidents involving approximately 164,181 drivers. The Department of Highways and Public Transportation estimates the total economic loss from all motor vehicle accidents in South Carolina for 1977 was $270 million. The economic loss from motor vehicle accidents has increased 250.6% in the ten years from 1968-1977.

GRAPH 1


MOTOR VEHICLE MILEAGE DEATH RATE
1955 - 1977
DEATHS PER 100 MLLION
VEHICLE MILES OF TRAVEL
10
8
6
4
2
0
1955
1957
1959
1961
1963
1965
1967
1969
1971
1973
1975
1977
SOUTH CAROLINA AVERAGE
NATIONAL AVERAGE*
* SOURCE NATIONAL SAFETY COUNCIL

Another contributing factor to South Carolina's high insurance losses is the State's judicial system and South Carolina's high propensity to bring legal suit. For instance, one major insurer reports that in South Carolina the frequency of bodily injury lawsuits per number of claims is four times that of North Carolina which has the lowest insurance rates in the country. In general South Carolina's legal system makes it easier to bring lawsuits and receive higher settlements than in North Carolina. For example, in North Carolina a person bringing suit for bodily injury can be required to submit to a physical examination from a physician other than his own, whereas in South Carolina the person is not required to submit to an adverse physical examination. For a more detailed comparison of the two states see Appendix III.

The goals of any insurance system are to make insurance affordable as well as available and to provide proper benefits to accident victims. Also the system can establish monetary incentives for individuals to drive more responsibly with fewer accidents and fewer losses.

In 1974, the General Assembly passed the Automobile Reparations Reform Act which completely reformed South Carolina's automobile insurance system. This Act was an attempt to solve many of the State's automobile insurance problems. The availability as well as affordability of automobile insurance had become a growing concern. Prior to 1974, companies could non-renew or cancel an insurance policy at their own discretion. Many persons were being discriminately placed in the Assigned Risk Plan (ARP) with rates 50% to 100% higher than the normal market. Although the industry insisted its underwriting methods were valid, more than 70% of the drivers in the ARP had a clean driving record - no accidents/violations over the last three years.

Also there was the problem of protecting accident victims from uninsured motorists. The 1959 Uninsured Motorist Law required uninsured motorists to pay an annual fee of $20 to help compensate the accident victims caused by these drivers. This fee continually increased until in 1972 the State required a fee from every insured to help pay for the damage done by uninsured motorists.

In addition, no uniform risk classification plans based on objective, statistically verified data existed. Prior to 1974 each company or rating bureau had its own risk classifications, resulting in almost as many categories as there were drivers. These classifications were not uniform and prevented the development of useful data with which to test the validity of the risk assessments.

By 1974 the automobile insurance system was in a crisis condition and in need of reform. The problems were complex and far-reaching. As a 1973 special legislative committee concluded: "the problem with automobile insurance in South Carolina wasn't simply the problem of the Assigned Risk Plan or even whether or not to adopt no-fault insurance. There were also problems of the complete availability of automobile insurance to the South Carolina motorist; the problem of the uninsured motorist and the habitual offender; the problem of automobile insurance premium rates. Every issue was like a tentacle growing out from a key issue - automobile insurance."

As a result of this need for reform, the 1974 Automobile Reparations Reform Act was passed. There were many components to this legislation but five stand out as the most significant:

(1) Compulsory Insurance - Every driver was required to possess liability insurance at the minimum limits of 15/30/5.

(2) Mandatory Writing of Insurance - Companies were required to provide auto insurance to anyone who desired it and were limited as to when a policy could be canceled.

(3) Reinsurance Facility - The Assigned Risk Plan was abolished and the Facility established to provide companies with a mechanism to share the losses caused by the "bad risks."

(4) Risk Classification Plans - Uniform risk and territorial rating plans were established and were to be based on statistically verifiable data.

(5) Merit Rating Plans - This plan was established as an incentive for safe driving. Drivers would be surcharged based on driving violations over a three-year period.

Act 1177 - Problems and Accomplishments

Compulsory Insurance

In South Carolina every driver must possess automobile liability insurance - it is compulsory and there are legal penalties for driving without insurance. South Carolina statutes (Section 56-11-720, 1976 Code of Laws) set the minimum liability coverage motorists are required to purchase: $15,000 for any one injury caused by a car accident; $30,000 for all injuries from an accident, and $5,000 for property damage. Uninsured motorist coverage at the same minimum dollar value is also compulsory; it pays the insured if he or she is hit by an uninsured motorist.

According to the South Carolina Law Review the purpose of compulsory insurance is "to provide a financially responsible defendant for every person injured in an accident." The result of this, optimumly,

would be to eliminate uncompensated victims of accidents. At present, a total of 26 states have compulsory insurance. However, even in a state with compulsory insurance not all drivers will be insured. Estimates place an average of 2 to 3 percent of drivers are uninsured. Thus, compulsory insurance is not 100 percent effective. Motorists who have let their policies lapse, drivers of stolen vehicles, visitors from states which do not have compulsory insurance and others will not be insured. That is why every state which has compulsory insurance (with the exception of Maryland) has retained the uninsured motorist requirement.

Recently, however, there have been several criticisms of compulsory insurance in South Carolina. The first objection is that compulsory liability insurance is rapidly becoming too expensive for the average citizen. As rates continue to rise a growing portion of the State's population will be unable to afford even the minimum amount of protection mandated by law. This may have a dual effect of aggravating the problem of availability and forcing more drivers to break the law and become uninsured motorists. Another criticism is that the limits for bodily injury protection are too high. Critics argue that in a state where 66% of the families earn less than $10,000 a year, only a minority of the population needs insurance which will protect a $30,000 estate.

Mandatory Writing of Insurance

All insurance companies in South Carolina must provide auto insurance to anyone who desires it. This "take all comers" provision is mandated by Section 38-37-310 of the 1976 Code of Laws. The statute

specifies that the only reasons an auto insurance policy can be cancelled are: 1) license revocation, 2) existence of a valid outstanding judgment due to failure to pay insurance premiums, and 3) failure to pay premiums when due. Insurance companies cannot pick and choose their clients.

Mandatory writing is an important component of the concept of compulsory insurance. Since liability insurance was required by the Act, provisions were made to enable a motorist to acquire insurance without unnecessary, irrational and undue burdens. The mandate to write all comers allowed all citizens to acquire insurance and to do business with the company of their choice.

There are, however, certain criticisms of the mandate to write insurance. Most of these deal with the effect of the law on insurance companies. One argument is that the mandate results in tight restrictions on industry. Because companies cannot choose clients, there is an adverse effect on losses. This in turn has an adverse effect on the competitiveness of the marketplace. Also some companies maintain that since all applicants are written at the company's "preferred" risk level, the low risk driver is subsidizing the high risk driver. This is a valid point in that under the old system high risk drivers were immediately charged higher rates. However, statistics show that the majority of persons whom companies considered "high risks" actually had clean driving records - no accidents or violations over a three-year period. Under the current system the bad driver pays higher rates, not the "high risk" driver. Since the bad drivers cannot possibly pay for the total amount of losses in the system these losses are spread throughout the entire driving population.

Another argument is that the mandate stifles competition among companies. Some companies claim that more and more drivers are obtaining insurance from larger companies who are better able to withstand the high loss market in South Carolina. This reduces the competitive position of smaller companies. In one instance, a major auto writer in South Carolina stated that "the 'take all comers' aspect... places agents in the position of competing in how not to sell insurance."

The Reinsurance Facility

When the Automobile Reparations Reform Act of 1974 forced automobile insurance companies to sell insurance to any customer who walked in the door, it was felt the industry needed an escape valve to take the place of the Assigned Risk Plan. The Reinsurance Facility was designed for this purpose.

The Facility has eliminated the worst abuses of the Assigned Risk Plan. No longer can companies use subjective factors such as a person's occupation, income or race to discriminate against certain drivers and charge them higher rates. The same rate is charged for everybody within a certain risk class, based on the factors of territory, age, sex and driving record. Drivers who have been placed in the Facility do not know they are in it, thus, there is no "stigma" attached.

Under the Facility system, a company may reinsure any risk it feels is undesirable. This process is actually a bookkeeping transaction, whereby the company sends in the premium, minus its expenses incurred in writing the risk. These premiums make up the "reinsurance pool." The pool bears any loss incurred, but the company and the agent

continue to service the risk. It is mandatory that all companies writing auto insurance in South Carolina belong to the Reinsurance Facility. A company can place (cede) up to 35% of its business in the Facility. Any losses the Facility incurs are shared by all companies in the Facility based on each company's premium volume.

The Reinsurance Facility is inherently an expensive system to operate. This is because every policy or risk placed with the Facility must be processed twice: once by the insurance company and a second time by the Facility. The Facility must keep track of several hundred thousand policies from hundreds of sources. Although this task is not unmanageable using data processing technology it is expensive.

Many auto insurance companies oppose the Reinsurance Facility. Eighteen out of thirty-five auto insurance companies surveyed by the Council felt the Facility should be abolished. The companies said the Facility's data processing requirements make it inefficient and unwieldy to operate; that it erodes companies' own management control; and that the cessions limitation is unfair since companies must take any customer who walks through the door yet can place only 35% of their business to the Facility.

It is the Facility's losses that most companies oppose. In the year ending September 30, 1978, the Facility had a loss ratio of 79% and ran a $19,227,021 deficit. In other words, premiums contributed by the drivers in the Facility were $19 million less than losses paid out. The Facility has lost $103.8 million from its inception in October 1974 to September 1978. If the Facility had operated under the Assigned Risk Plan method, those policyholders in the Facility would have paid an

additional $71.29 a year to cover that deficit. As it is, the loss is spread among all insured drivers and amounts to about $19.02 a year per policy. Insurance companies believe that drivers in the Facility should be made to pay for their own losses and be charged a higher rate. Under the present system, the preferred or "good risk" drivers subsidize those drivers companies consider "bad risks." However, there is a difference in a bad driver - one who causes an accident - and a bad risk. Insurance underwriting is not an exact science, nor was it intended to be. According to one major auto insurance company: "Risk assessment means the correct evaluation of loss potential, not the correct prediction of actual losses." While risk underwriting may hold true for a group, it will not always be fair in individual cases.

Risk Classification Plans

Auto insurance rate making in South Carolina is now based upon uniform risk classification plans, mandated by Act 1177. There are three plans: (1) a risk classification based on age, sex, marital status and use of the car; (2) a territorial plan based on the person's residence in one of 8 territories; and (3) a merit classification plan based on the policyholders' motor vehicle records.

The risk and territorial classification plans assess policyholders as a group; the merit plan rates policyholders on an individual basis. The risk plan divides drivers into nine categories, with unmarried males under age 25 paying the highest premium rate, about three times the base rate. Policyholders who drive their cars more than ten miles each way to work also pay a higher rate, while adults over 25 who use their vehicles for pleasure only pay a low rate. Territories with large urban centers such as Columbia or Charleston have the highest rates.

The Audit Council found the risk classification plan to be unfairly discriminatory resulting in an inequitable insurance pricing structure. Drivers with a clean record (no traffic violations or accidents) often pay high premiums because they belong to a "high risk" group. An extreme example of this inequity would be a case where the young unmarried male with a clean driving record pays as much for auto liability insurance as an older man who is also surcharged for a serious driving offense (see example below).

RISK COMPARISON CHART

Driver*	Liability Premium	Surcharge for Violation	Total Premium
Underage Male	$485	0	$485
Adult Male	$172	$300**	$472

*Rates are for Columbia territory, the same model car and the same insurance company.

**Surcharge is for a DUI conviction.

The reason the risk classification plan is discriminatory is because, it is largely based on factors which are not "controllable" (i.e., sex, age and marital status). "Controllable" means the ability of the insured to effect his own potential for risk and thereby react positively to incentives created by the insurance pricing system. Rating factors such as driving records or weekly commuting distance are within the control of the individual. But no individual can control his age or sex; thus, drivers are being "penalized" for factors beyond their control.

Insurance companies have always found it profitable to separate and price groups of drivers with different loss characteristics. There is some statistical data to show that males under age 25, for example, as a group, do experience more than their share of accidents. However, there is strong doubt as to whether these classifications are very accurate. A report by the Stanford Research Institute estimated that existing classification systems account for only 22% of the variations in losses among individuals. A similar study done by the Massachusetts Department of Insurance indicates that a traditional rating plan based on age, sex and marital status would explain between 10% and 12% of the loss variations among that state's motorists.

Massachusetts and North Carolina in 1977 eliminated rating systems based on age, sex and marital status and implemented an experience-based system. In Massachusetts, five new driver classes were created: 1) a standard, experienced driver class, 2) a class for drivers over age 65, 3) an inexperienced driver class for policyholders without driver training, 4) an inexperienced driver class for those with driver training, and 5) a class for those who use their vehicles in their businesses. Individual surcharges for violations or accidents are then added on to the premium.

In mandating the new rating plan the Massachusetts insurance commission stated that:

> "The new classification plan is designed to maximize individual incentives by deemphasizing rating factors beyond an individual's control... The resulting classifications and relative premium burdens will not just be fairer. They will help restore to the insurance system one of its most important, and most forgotten, attributes: the incentive for improvement."

In North Carolina, the risk classification plan is composed of three equally weighted factors: use of the car, driver's experience and individual driving records.

In addition, the NAIC, in its own study of risk classification, found that:

> ...while there appears to be some statistical evidence justifying the continued use of age, sex, and marital status as rating factors, this evidence is subject to question in many cases. The evidence also indicates, however, that there exist many alternative rating factors which perform as well as age, sex, and marital status on statistical grounds, and which are considerably more acceptable for rating purposes from a public policy perspective.

The traditional rating factors of age, sex, and marital status are inherently unfair. All too often they have no relationship to the individual's actual driving record. Furthermore, this type of rating system makes no attempt to influence loss patterns, it merely observes them. Risk classifications within the control of the individual can be used as an effective incentive toward safer driving.

Merit Rating Plan

One of the reforms of Act 1177 was the establishment of a merit rating plan. This plan provides a safe driver discount for drivers without traffic violations and applies a surcharge to drivers for accidents and other traffic violations as an incentive toward safe driving. The Council reviewed the merit rating plan and found that it is not working. The plan is not being enforced and the level of penalties is not adequate to act as a deterrent to unsafe driving.

There are several reasons why the plan is not working. It is questionable whether the surcharge penalties are tough enough. North Carolina has a similar merit rating plan and its surcharges are a great deal higher than in South Carolina especially for speeding violations (North Carolina has the lowest insurance rates for mandatory coverages

in the nation). South Carolina assesses no surcharge for a first conviction of speeding less than 10 mph over the speed limit. In North Carolina this same conviction raises the premium 40%. North Carolina increases are based on a percentage of premiums thus, second and third offense violations are much higher than South Carolina which is based on a set dollar amount.

Another reason the plan is not working is that companies are not charging everyone responsible for accidents or with traffic violations. The Department of Highways and Public Transportation (DHPT) reports that in FY 77-78, 835,151 motor vehicle records (MVR'S) were obtained by companies. This represents only about half of the drivers in the State. Insurance companies have not obtained MVR'S on each driver because insurance agents have no way to do so quickly, easily, and inexpensively. Companies must pay DHPT for this information ($3 for each MVR) and some companies feel it is not worth the expense to obtain the MVR.

Another reason the plan is not working is lack of enforcement by the Insurance Department. The Department does few underwriting audits to see if companies are obtaining motor vehicle records and are properly surcharging persons with traffic violations. In addition there has been little coordination between the Department and DHPT to make driving records inexpensively and easily assessible to the companies.

Because of the incompatibility of DHPT traffic records and insurance company records, it was impossible for the Council to determine to what extent drivers are being surcharged correctly. However, it is apparent that many drivers are not being surcharged for their traffic violations.

The purpose of the merit rating plan is to provide an incentive for persons to drive more carefully. Those individuals who continually break traffic laws and cause accidents should be held more economically responsible for their actions. The merit rating plan is an incentive mechanism aimed at safer driving resulting in fewer accidents and lower insurance losses.

To date the merit rating plan has failed to entirely meet these objectives. Many individuals have not always been held accountable for their unsafe driving habits through higher insurance premiums. The ultimate goal of fewer accidents, lower insurance losses, and lower insurance premiums has not been achieved. Until hazardous driving habits make a substantial dent in their pocketbooks, South Carolinians will have little incentive to drive more carefully.

Conclusion

In South Carolina the year 1974 saw a major transformation in automobile insurance. The Automobile Reparations Reform Act brought positive changes: full availability, the end of the assigned risk plan's unfair and discriminatory underwriting practices, uniform rating and territorial rating classifications, a surcharge system based on an individual's driving record and the guarantee of financially responsible motorists. However, the present system is not without its problems and improvements are needed.

In any system which is constantly changing and affects so many people, there will be tradeoffs between the cost of the system and its benefits. Compulsory insurance has provided a system of financially responsible motorists but forces many individuals to purchase insurance

they normally would never buy or cannot afford. The mandate for companies to "write all comers" insures full availability of insurance for purchasers but places a hardship on companies since they no longer can select whom they will insure. The reinsurance facility has proven to be an effective mechanism in eliminating unfair and discriminatory underwriting but it is expensive to operate and needs improving. The rating classification plan is now uniform for all companies but there is a need to eliminate discriminatory pricing based on criteria such as age, sex, and marital status which are beyond a person's control. The merit rating plan's objectives are reasonable but in order for them to be achieved the plan will have to be strengthened and enforced.

These components of the insurance system all affect the cost of insurance to the individual policy holder. They do not affect the provision of benefits to the accident victim. The automobile insurance system, however, can maximize the use of insurance dollars and ensure that accident victims are compensated in a timely, equitable and efficient manner. It is in this area that South Carolina's present automobile system can be improved. The following chapter will examine an alternative that provides more equitable benefits to accident victims.

RECOMMENDATIONS

SOUTH CAROLINA'S RISK CLASSIFICATION SYSTEM SHOULD BE REVISED TO ELIMINATE AGE, SEX AND MARITAL STATUS AS RATING FACTORS. MORE FACTORS SUCH AS DRIVING RECORD AND DRIVING EXPERIENCE SHOULD BE SUBSTITUTED AS THE PRIMARY BASIS OF RISK ASSESSMENT.

THE MERIT RATING PLAN SHOULD BE STRENGTHENED AND ENFORCED TO PROVIDE MORE SUBSTANTIAL PENALTIES FOR DRIVING VIOLATIONS.

THE DEPARTMENT OF INSURANCE IN COORDINATION WITH THE DEPARTMENT OF HIGHWAYS AND PUBLIC TRANSPORTATION SHOULD DESIGN AND IMPLEMENT A SYSTEM FOR TRANSMITTING MOTOR VEHICLE TRAFFIC VIOLATION RECORDS TO INSURANCE COMPANIES AT MINIMAL COST TO THE COMPANIES.

THE DEPARTMENT OF INSURANCE SHOULD PERIODICALLY CONDUCT UNDERWRITING AUDITS IN ORDER TO DETERMINE IF INSURANCE COMPANIES ARE SURCHARGING DRIVERS BASED ON THE PERSON'S MOTOR VEHICLE RECORD. THE MERIT RATING PLAN SHOULD BE STRICTLY ENFORCED BY THE DEPARTMENT WITH PENALTIES AND FINES ESTABLISHED FOR COMPANIES NOT FOLLOWING THE PLAN.

CHAPTER 4

NO-FAULT INSURANCE

Introduction

In reviewing South Carolina's automobile insurance system, the Audit Council found that there are several major deficiencies in the manner in which accident victims are compensated. The Council analyzed systems, mechanisms, and programs used by other states to provide this compensation and found that the one successful alternative system used was no-fault insurance.

This chapter analyzes the State's present method of compensation, the tort liability system, and reviews its weaknesses. The major alternative system of no-fault insurance is examined and the experience of the sixteen no-fault states is reviewed in detail. Also, presented are possible solutions to the deficiencies found in the current system of accident compensation in South Carolina.

One of the major problems of the auto insurance system is providing benefits to accident victims on a fair and equitable basis. South Carolina, along with most states, continues to rely on the traditional tort liability system and the judicial process to provide these benefits. During the past decade, however, several states and the Federal Government have become dissatisfied with the inherent weaknesses in the tort system. This has led to the espousal of an alternative system, no-fault insurance.

In a no-fault system an individual insures himself against the risk of economic loss from his own injuries regardless of who was at fault, instead of insuring himself against causing economic loss to others. This is the same concept upon which private health insurance and social

security are based. The Department of Transportation (DOT) in their 1977 report entitled State No-Fault Automobile Insurance Experience 1971-1977 states that there is no standard definition of the term "no-fault automobile insurance." However, all current systems have three major characteristics which distinguish them from tort liability insurance. Those characteristics are:

(1) "Mandatory economic loss benefits are, to the extent of the no-fault coverage provided, available to all victims regardless of fault.

(2) No-fault insurance benefits for economic loss supplant tort liability insurance for compensating the same loss.

(3) Some restriction is placed on the victim's right to sue in tort for intangible damages (e.g., 'pain and suffering')."

Thus far, sixteen states have enacted reparation plans which have these three characteristics. An additional ten states have adopted plans which incorporate one or two of these characteristics. South Carolina's optional personal injury protection has characteristics of no-fault insurance.

Origins of No-Fault

The prevailing system of automobile accident compensation, tort liability insurance, first came under criticism in the mid-1920's by a number of legal experts. The most notable critic was Judge Robert Marx who proposed no-fault in Ohio in 1925. Over the next forty years tort liability came under increasing attack but widespread public attention was not generated until the 1965 publication of the Keeton/O'Connell study entitled Basic Protection for the Traffic Victim. Not only did this study present persuasive arguments for no-fault but it provided

legislators with a comprehensive legislative model for implementing no-fault. At this time automobile insurance reform was a major issue in Massachusetts. The introduction of the Keeton/O'Connell proposal and the ensuing debate in Massachusetts focused national attention on the no-fault concept for the first time. Several Congressional Committees also began looking into no-fault. Studies were begun investigating accident compensation reform and no-fault in particular. Instead of waiting for the results of these studies Massachusetts, in 1970, passed the first no-fault law. In 1972, model legislation for no-fault was developed by Congress. Of the sixteen states who subsequently have adopted no-fault, Michigan's system appears to conform the closest to Federal recommendations. In recent years Congress has actively considered proposals to require all states to enact no-fault legislation based on Federal guidelines.

The Present System - Tort Liability

In South Carolina, as in the majority of states, automobile accident insurance is based upon the tort liability system. The tort system rests upon the concept that negligence as "fault" is involved. Liability insurance provides the means for paying for damages resulting from the liability (accident). In order to recover compensation in a tort liability or "fault" system, several criteria must be met:

(1) A victim must first identify and show that another driver was at fault. (There will be no compensation if the accident involves only one vehicle.)

(2) A victim must show that he or she was without fault or less at fault than the other driver.

(3) The victim must obtain settlement or prevail in a lawsuit.

(4) The party at fault must have sufficient resources or insurance to pay for the victim's losses.

As a 1978 U. S. Senate report on no-fault points out:

> ...fewer than fifty percent of motor vehicle accident victims meet all these prerequisites and recover benefits under the fault system. The others are left to their own financial resources, or other insurance, even though they have purchased automobile insurance. Some victims even become dependent on Federal or State assistance.

A New York study of auto insurance points out that when tort law developed centuries ago there were no automobile accidents. In 1977, there were over 26,716,000 accidents in the United States. The study goes on to say that it is easy to see that "...the fault law, the courts and liability insurance were not designed to deal with the accident-causing propensity of the modern automobile."

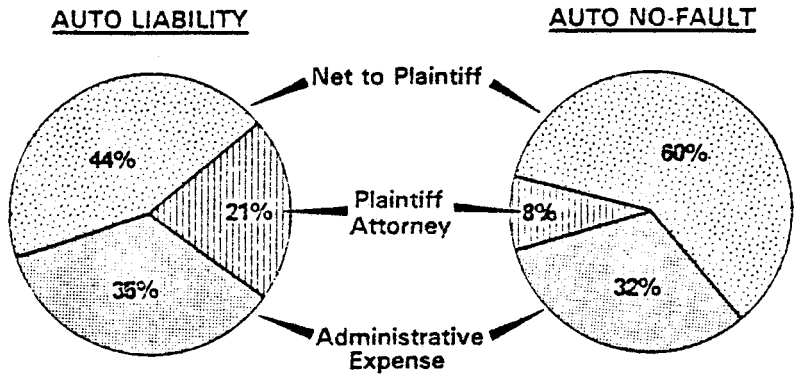
Many studies have pointed out the inefficiencies and inequities of the present tort liability system. Listing and explaining all of these criticisms would involve many pages of discussion. The following is a summary of the most important and most frequently mentioned complaints.

(1) Inefficiency

According to a 1971 Department of Transportation study, only 44 cents of each premium dollar is returned to the victim in the form of benefits to compensate injuries (see Table 3). This compares with a return benefit of 70 to 90% for other insurance systems such as group health insurance, workmen's compensation and social security. Much of this 44 cents goes to pay for non-economic losses (pain and suffering) rather than actual injury benefits. A 1970 New York study estimated that under the New York tort system only 14.5 cents of every premium dollar actually reached the accident victim as compensation for economic loss.

TABLE 3

Distribution of the Premium Dollar: Auto Liability and Auto No-Fault



NOTE: For auto liability, about 1% of the premium dollar is absorbed by costs that the plaintiff must pay. The percentage shown for plaintiff attorney includes the large number of cases in which the plaintiff hires no attorney.

SOURCE: Derived from *Auto No-Fault*, State Farm Mutual Automobile Insurance Company, and *Motor Vehicle Crash Losses and Their Compensation in the United States*, 47-52, (DOT 1971)

Source: Report of the Senate Committee on Commerce, Science and Transportation, Standards for No-Fault Motor Vehicle Accident Benefits Act, 1978.

(2) Inadequacy of Compensation

More than half the people injured in auto accidents receive no benefits under the tort system. A 1970 DOT study points out that only 45% of seriously injured victims recovered anything from the tort system. Of the 45% who did recover, more than 25 percent recovered less than one half of their economic loss.

(3) Unfair and Unreasonable Distribution of Benefits

The tort system unfairly overcompensates victims with less serious injuries and compensates the more seriously injured victim inadequately or not at all. The 1971 DOT Closed Claims Study revealed that it is the minor injury which receives proportionately the largest award. In 77% of cases where economic loss was $200

or less, the claimant was paid more than twice his economic loss. Thus, non-economic loss (pain and suffering) exceeded payments for economic loss. This trend continued in 55% of cases involving economic loss between $201 and $1,000. A similar DOT study also pointed out that in cases involving large economic losses of $25,000 or more, even successful tort claimants averaged a net recovery of only one-third of their economic losses.

There are several reasons for this situation. Small claims are usually settled on quite generous terms because it is often cheaper for insurance companies to overpay a small claim than defend it in court. This is particularly true of the "pain and suffering" claim. Conversely, large claims are very expensive to litigate. These cases can take many months or years to settle, often depleting the financial resources of the claimant before they are settled. Insurers can attempt to induce lower settlements or delay the case until the claimant accepts a less than adequate amount. Also, tort settlements are generally of a lump sum nature. Thus, the victim is less likely to receive compensation for a total economic loss which may last for a lifetime. As a 1969 American Bar Association report states "The worse the case, in terms of loss, the greater the statistical chance of receiving inadequate reparation."

(4) Hindrance to Rehabilitation

The first objective of any reparation system should be to rehabilitate injury victims. Rehabilitation enables the victim to return to some form of normal life and contribute to society. The tort liability system does not promote rehabilitation but hinders it. As previously stated, the least is paid to the most seriously injured.

If payments are awarded, they often come too late. The lump sum nature of the tort system means that any allowance for future rehabilitation can only be estimated and may not be available when needed.

(5) Excessive Use of Courts - This results in long delays for other serious civil or criminal cases.

(6) Discrimination Against the Poor - This occurs because the poor have the least resources to fall back on in the event of a long, involved lawsuit.

(7) Lack of Coordination of Benefits - The tort system does not consider benefits received from health insurance, workmen's compensation and other sources when awarding settlements.

(8) Dishonesty and Fraud - Considering the types and amounts of settlements awarded, the victim has every reason to exaggerate his losses. Conversely, the insurer has every reason to resist and delay. In this process the system becomes grossly inefficient.

(9) Detrimental Effect on Insurance Consumers and Companies - The high cost of settlements has to be absorbed by someone. In the end it is the policyholder who pays for these costs. Companies also have to utilize other methods of controlling losses. Generally this is done by subjective underwriting. In an environment such as South Carolina's where subjective underwriting is illegal, the company simply loses money.

These are the major criticisms of the traditional tort liability system. As described, it is a system which places adjudication and proving fault above reparation and rehabilitation of victims. It is time consuming and expensive for all parties involved. Often, those needing the most relief actually receive the least amount of benefits or no benefits at all. The goal of no-fault insurance is fundamentally reform the traditional tort liability system.

The No-Fault Alternative

No-fault insurance does not attempt to modify the tort liability system but serves to replace it. A 1978 report by the Senate Committee on Commerce, Science and Transportation recognizes that there are two basic requirements for an injury automobile accident compensation system: it should compensate all accident victims for their total economic loss, and it should return as much of the premium dollars to accident victims as possible.

The Committee found, after hearing testimony from no-fault State insurance experts, legal experts and industry, that no-fault can and does achieve these goals. The Committee also established standards for no-fault which, if enacted, would have mandated no-fault insurance on a national level (see Appendix IV).

In 1977 a DOT study of the performance of no-fault insurance plans in 16 states was released. This study used several criteria in order to evaluate the performance of no-fault insurance in the sixteen no-fault states. The following is an analysis of this study including new information recently obtained from the no-fault states.

(1) The Adequacy of No-Fault Benefits

One of the principal goals of no-fault is to correct the serious imbalance between the economic losses sustained by accident victims and the compensation they receive. Although data is not available from all no-fault states, existing research information indicates that no-fault is compensating more accident victims more completely and equitably for their economic losses than did the tort liability system. For example, new data from Michigan's Insurance Bureau reveals that real payments for economic loss jumped over 60% with the introduction of no-fault.

TABLE 4

MICHIGAN ECONOMIC LOSS PAYOUT - 1971-1976

Top Six Companies

(Corrected for Injury Frequency and Cost of Living)

Pre-No-fault	1971	$39,200,000
	1972	$44,800,000
9 months pre-3 months post-No-fault	1973	$48,400,000
Post-No-fault	1974	$70,200,000
	1975	$70,400,000
	1976	$71,600,000

Source: No-Fault Insurance in Michigan: Consumer Attitudes and Performance, Michigan Insurance Bureau, 1978.

Data from the top six insurers in Michigan shows that payments jumped from $44.8 million in 1972 (last year of the tort liability

system) to $70 million in 1974 (first full year of no-fault). This demonstrates a substantial increase in benefits going directly to accident victims to pay for actual damages. The source of this additional $24.2 million was mainly from payments which previously went to non-economic (pain and suffering) benefits.

Other data from Michigan shows that prior to no-fault only 45% of total payouts were for real economic loss. After no-fault the percentage had increased to 64%. This represents an extremely beneficial shift in the distribution of losses. DOT studies in other no-fault states have revealed similar results. DOT concluded that "no-fault...accomplishes in practice what it was designed to do in principle; i.e., provide compensation for the economic losses of accident victims in a manner more adequate and equitable than the tort liability system."

(2) The Timeliness of No-Fault Benefits

A second key criterion is the timeliness of the delivery of benefits. Compensation for economic losses that is adequate in dollar amounts but long-delayed in arrival cannot be termed "adequate" compensation. This forces the accident victim to bear the burden of losses during the period between accident and settlement. A DOT study found that the average wait for payment under the tort liability system was sixteen months. A 1970 New York Insurance Department study found that:

> "injured victims of automobile accidents face average delays in collecting automobile liability insurance that are 10 times as long as the delays collecting under collision, home owners or burglary insurance and 40 times as long as delays under accident and health insurance."

In contrast, evidence from no-fault states demonstrates that most claims are paid promptly and without dispute. A 1972 Massachusetts claims study shows that within 90 days of the accident 63.3% of claimants had received their first payment (see Table 5). One year after the accident only 5.5% of claimants had not received their first payment.

TABLE 5

PERCENTAGE DISTRIBUTION OF MASSACHUSETTS PIP (PERSONAL INJURY PROTECTION) CLAIMANTS BY ELAPSED TIME FROM ACCIDENT TO FIRST PIP PAYMENT

(1972)

Number of Days	Percentage of PIP Claimants Paid	Cumulative Percentage
1 - 6	0.3%	0.3%
7 - 30	16.1%	16.4%
31 - 60	27.3%	43.7%
61 - 90	19.6%	63.3%
91 - 120	9.9%	73.2%
121 - 180	11.6%	84.8%
181 - 240	5.5%	90.3%
241 - 365	4.2%	94.5%
More than 365 days	5.5%	100.0%
TOTAL	100.0%	100.0%

This compares to a 1972 DOT study which shows that nationally, 24.1% of claimants had not received their first payment one year after the accident. This speedy claims delivery is not limited to Massachusetts. Michigan reports that "all Michigan policyholders are receiving PIP (no-fault) benefit payments without undue delay and virtually all claims are paid within the 30-day time limit." Colorado has found that 59% of its no-fault claims are settled

within three months and 91% within six months. New Jersey reported in 1974 that nearly 80% of the 26,000 motorists injured during the first six months of 1973 were paid for claims by September of 1973. The 1972 figure for New Jersey (pre-no-fault) was 50%.

The evidence from these no-fault states clearly indicates that benefits are being paid more promptly under no-fault than they were in the tort liability system. This is to be expected since first party, no-fault claims are easier to process than tort liability claims which involve not only determination of fault but often lead to lengthy judicial review.

(3) Coordination of No-Fault Benefits With Other Insurance Systems

The introduction of no-fault insurance can duplicate existing insurance coverage if provision is not made to coordinate new no-fault benefits with other types of insurance. This results if a victim is covered by workmen's compensation, accident and health insurance or other benefits. However, if coverages are coordinated, there can be substantial premium savings for the public. In Michigan this coordination is optional. Michigan Insurance Bureau actuaries have estimated that if full coordination were achieved it would result in an annual savings of $105 million in premiums. New York has estimated that if duplication between auto and health insurance were eliminated, New Yorkers could save approximately $75 million a year in health insurance premiums. New Jersey reports that their mandatory coordination between no-fault insurance and non-profit health plans (i.e., Blue Cross and Blue Shield)

has already resulted in a 3% premium reduction. Information from other states seems to bear out that significant net savings throughout the entire insurance system can be achieved if no-fault benefits are coordinated with other coverages.

(4) The Impact of No-Fault on the Court System

One of the goals of no-fault is to reduce the amount of the court system's resources tied up in motor vehicle tort litigation. The no-fault restrictions on tort recovery are designed to eliminate nuisance suits for "pain and suffering." There are basically two types of no-fault thresholds a claimant must pass before suit can be filed. Some states allow suit after economic damages exceed a specific dollar limit. Other states have a "verbal" threshold which allows suit for intangible damages only in the case of death, permanent disfigurement or total disability for a fixed period of time. Reports have shown that the "dollar" threshold has encountered some difficulty. Inflation has eroded its effectiveness as a cost saver. In addition, a specified dollar amount has given victims and their lawyers something to "shoot for," thereby resulting in unneeded treatment or fraud. States with a "verbal" threshold appear to have none of these problems.

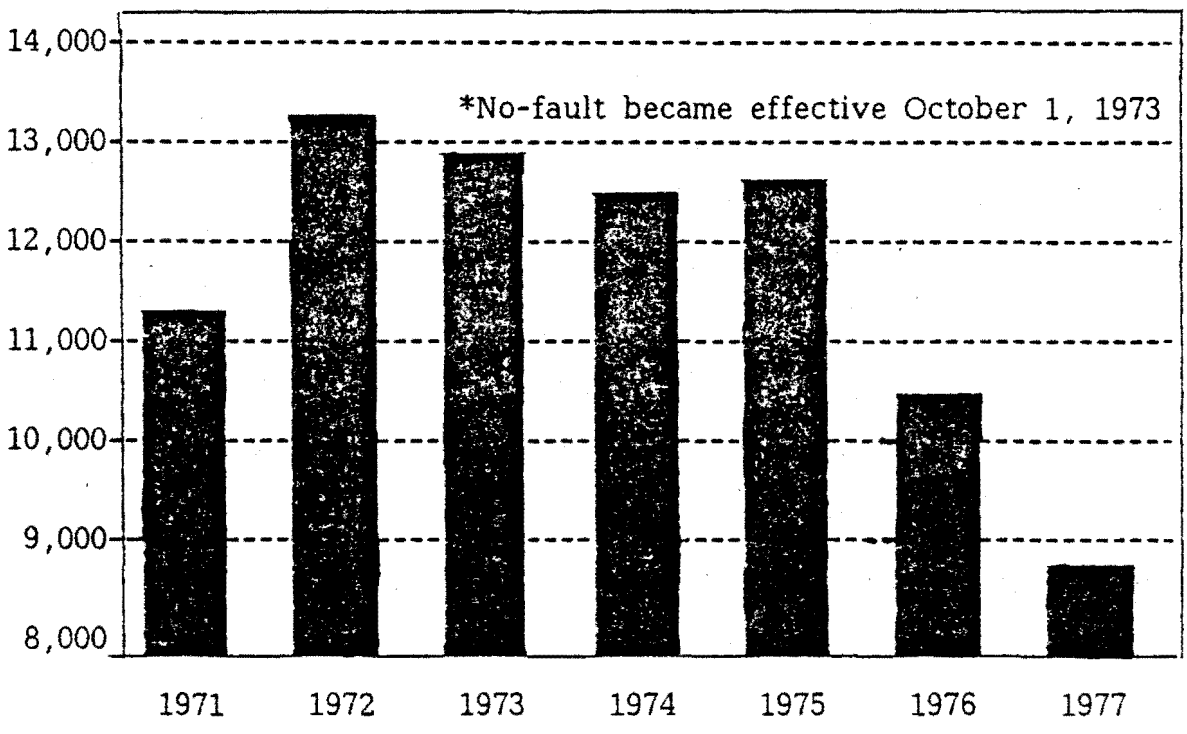
A 1971 DOT study found that motor vehicle accident litigation occupied approximately 17% of the nation's court resources. Information provided from no-fault states has shown that motor vehicle accident litigation had declined significantly with the advent of no-fault. A 1976 study of five of the fifteen counties in Massachusetts reveals that bodily injury tort cases declined by 89% in district courts as an effect of no-fault. Similar reductions have occurred in Michigan. Since no-fault became effective the number of auto

accident cases decreased 31% (see Table 6). Other states have reported similar declines. Although there are factors other than no-fault which affect the level of motor vehicle tort litigation (such as accident rate and litigiousness of the population), it is clear that no-fault insurance has played a major role in reducing tort action. This type of reduction has a favorable effect on all citizens because it lowers court costs and increases court efficiency.

TABLE 6

MICHIGAN CIRCUIT COURT AUTO NEGLIGENCE

CASES FILED, JANUARY 1971 - JUNE 1977



Source: No-Fault Insurance in Michigan, Insurance Bureau, Michigan Department of Commerce (1978).

(5) The Impact of No-Fault on the Rehabilitation of Accident Victims

In view of the detrimental effects of the tort liability system upon rehabilitation of accident victims, it is important that no-fault address these problems and provide more incentive for rehabilitation. Although little statistical information is available, some broad conclusions can be made. Three no-fault states provide for unlimited first-party medical benefits. In these states any costs for reasonable rehabilitative services are automatically paid for. This means that an accident victim in these and other no-fault states is receiving wage loss, medical benefits and rehabilitative services instead of worrying about a lengthy tort process. As a representative of the American Academy of Physical Medicine and Rehabilitation summarized the rehabilitative aspects of no-fault:

> First, it focuses on meeting the needs of the injured, not on determining culpability;
>
> Second, it provides the individual the financial wherewithal to secure necessary services through coverage of medical and comprehensive rehabilitative services;
>
> Third, it provides the incentives in the direction of human restitution rather than retribution;
>
> Fourth, it does not siphon off resources paid in by way of insurance premiums for a wasteful and dehumanizing bargaining litigation - settlement contest, and;
>
> Fifth, it avoids catastrophic drainage of financial resources of the victim and his family that leads to their being forced to become welfare and Medicaid recipients.

Perhaps the greatest single contribution of no-fault insurance is the ability to make the injured person economically and physically whole as much as possible and thereby encourage his re-emergence as a productive member of society.

No-Fault Insurance and South Carolina

At present there is a lack of data which would provide a basis for precise prediction of the implications of no-fault insurance for South Carolina. Accumulation and analyses of the necessary data would require months of detailed study. In South Carolina no such studies have been conducted even though there has been a major impetus toward no-fault at the Federal level in recent years. There are, however, several broad conclusions which can be made using existing DHPT (Department of Highways and Public Transportation) statistics.

No-fault is aimed at providing immediate relief to those who suffer economic losses and injuries. In 1977, economic loss on the State's highways amounted to $270 million. This is an increase of 250.6% over the last ten years. Highway injuries in 1977 totalled 21,300. No-fault is also designed to provide adequate relief to the more seriously injured. In 1977, 35% of all highway injuries were classified as "incapacitating." Overall in 1977 there were 91,500 accidents in the State, which reflects a 57.2% increase in the accident rate in the last ten years.

No-fault auto insurance should help alleviate some of the insurance problems particular to South Carolina. For instance, it may help reduce the size of the residual market, since one characteristic of an "undesirable" risk is his or her ability to testify well in court. No-fault should also serve to reduce the number of auto liability-related cases in court. In South Carolina certain requirements make it easy to initiate a tort suit. The Department of Insurance has reported data from two major insurers that indicates that South Carolinians are twice as likely to sue for auto liability damages as are North Carolinians. NAIC data

indicates that companies spend millions of dollars a year for the administrative and legal costs of settling claims. No data is available which show what the policyholders spend in legal fees to obtain benefits.

Although it is difficult to draw precise conclusions from this preliminary data, it would seem to indicate that no-fault could be beneficial to South Carolina in light of the aforementioned highway losses and legal characteristics of the State. Any proposed no-fault legislation must carefully consider existing statutes regarding reparations. A New York study points out that overlaying no-fault benefits on a tort liability system could lead to an even more expensive reparation system. At present, South Carolina's optional Personal Injury Protection (PIP) does just that. As New York concluded,

> ...the overlay of a first-party, no-fault 'system' on top of the fault insurance system would just make the consumer pay to operate two reparation systems instead of one... these proposals would lead to virtually the largest imaginable duplication of benefits and increase in premiums.

Studies reviewed by the Audit Council recommend that if any move is made toward no-fault, the measure should reflect a total commitment using the Federal Proposal or Michigan's legislation as a model. As a 1977 California report states:

> Systems which aspire to no-fault objectives and advantages but which, in order to secure legislative approval, are riddled with gross theoretical and practical flaws and have unvariably created more problems than they have solved. If these flaws are the unavoidable price of enactment of no-fault legislation... then such legislation should <u>not</u> be enacted.

Summary and Conclusion

The purpose of this chapter has been to reveal some of the major shortcomings of the present tort liability system and to offer possible solutions. It has been shown that the tort liability system is inefficient, that compensation to the victim is often inadequate or nonexistent, benefits are distributed without regard to economic loss and it is a hindrance to rehabilitation. In essence, the tort liability system is inadequate in its ability to provide relief to many auto accident victims. The major alternative to the tort liability system is no-fault insurance. Although no-fault insurance has been in effect for less than a decade, it has proven that it is superior to the tort system in all critical areas. No-fault brings no promises of rate reductions or lowered costs, although this has occurred in several states. No-fault does, however, provide a plan by which accident victims are compensated quickly, more equitably and rehabilitation is encouraged. It also enables the insurance system and court system to operate more efficiently. The Department of Transportation study of no-fault concludes "No-fault automobile insurance works."

A no-fault automobile insurance system is a viable alternative to the present tort liability system. Based on the experience of other states and the U. S. Department of Transportation's studies, no-fault insurance best executes the purpose of insurance, which is to deliver benefits to accident victims in a timely, equitable and efficient manner. In addition, no-fault insurance, if fully instituted, should alleviate some of the present problems with auto insurance in South Carolina, such as:

- The drain of court expenses on premium dollars.
- The large size of the residual market.

- Over-insurance of people with assets less than $15,000.

However, it must be emphasized that if a no-fault reparation system is implemented, it must be made without compromise. Anything but a "pure" no-fault system such as exists in Michigan will only result in the placing of one reparation system on top of another, thus causing more problems than it will solve.

RECOMMENDATION

LEGISLATION SHOULD BE PASSED ESTABLISHING AN AUTOMOBILE NO-FAULT REPARATION INSURANCE SYSTEM IN PLACE OF THE TORT LIABILITY SYSTEM. THIS SYSTEM SHOULD INCLUDE THE FOLLOWING BENEFITS AND RESTRICTIONS:

BENEFITS:

(1) UNLIMITED MEDICAL CARE AND REHABILITATION EXPENSES.

(2) WORK OR INCOME LOSS BENEFITS UP TO $1,000 PER MONTH FOR A PERIOD OF THREE YEARS. THIS MAXIMUM SHOULD BE INCREASED ANNUALLY BASED ON CHANGES IN THE CONSUMER PRICE INDEX FOR SOUTH CAROLINA.

(3) REPLACEMENT SERVICES (I.E., HOUSEHOLD HELP) FOR ONE YEAR AT A RATE UP TO $20 PER DAY.

(4) DEATH BENEFITS FOR FUNERAL AND BURIAL EXPENSES OF $1,500.

(5) ADDITIONAL COVERAGES FOR REASONABLE ADDITIONAL AMOUNTS OF WORK LOSS BENEFITS, REPLACEMENT SERVICE BENEFITS AND DEATH BENEFITS MUST BE AVAILABLE ON AN OPTIONAL BASIS.

(6) OPTIONAL RESIDUAL BODILY INJURY AND PROPERTY DAMAGE LIABILITY INSURANCE WITH LIMITS TO $20,000/$40,000/$10,000.

RESTRICTIONS:

(1) TORT LIABILITY FOR GENERAL DAMAGES (NON-ECONOMIC LOSS) BE LIMITED TO CASES WHERE THE VICTIM: (a) DIES, (b) SUFFERS SERIOUS AND PERMANENT INJURY, (c) RECEIVES SIGNIFICANT SCARRING OR DISFIGUREMENT, (d) IS CONTINUALLY DISABLED FOR LONGER THAN THE LIMITATIONS PLACED ON WORK LOSS, OR REPLACEMENT SERVICES.

(2) MANDATORY COORDINATION OF NO-FAULT BENEFITS WITH BENEFITS OF OTHER INSURANCE COVERAGES ON AN INDIVIDUAL BASIS.

APPENDICES

APPENDIX I

SUMMARY OF SUNSET ISSUES

Act 608 of 1978, the "Sunset Act," established a process for the systematic review of agencies, boards and commissions to evaluate the need for their continuation, reorganization or termination. Under this law the Audit Council is instructed to review and evaluate the specific programs and functions of the agency or board. The law also specified that the Council include in its review information germane to the following eight issues.

(1) The amount of the increase or reduction of costs of goods and services caused by the administering of the programs or functions of the agency under review;

(2) Economic, fiscal and other impacts that would occur in the absence of the administering of the programs or functions of the agency under review;

(3) The overall cost, including manpower, of the agency under review;

(4) The efficiency of the administration of the programs or functions of the agency under review;

(5) The extent to which the agency under review has encouraged the participation of the public and, if applicable, the industry it regulates;

(6) The extent to which the agency duplicates the services, functions and programs administered by any other State, Federal, or other agency or entity;

(7) The efficiency with which formal public complaints filed with the agency concerning persons or industries subject to the regulation and administration of the agency under review have been processed; and

(8) The extent to which the agency under review has complied with all applicable State, Federal and local statutes and regulations.

The following is a summary of the Council's review of these issues addressed in the Act.

(1) The amount of the increase or reduction of costs of goods and services caused by the administering of the programs or functions of the agency under review.

The cost of any regulation is always borne by the consumer. The insurance industry, like all industries, passes all its costs on to the consumer. It is impossible to accurately estimate the total cost that regulation has on the price of insurance. However, a few specific items can be identified.

During FY 77-78 the Department of Insurance collected over $32.7 million in company taxes, company and agent license fees. This $32.7 million made up 2% of the more than $1.6 billion in premiums collected by the insurance industry in South Carolina. This revenue is deposited in the State General Fund to be used for the provision of services to South Carolina citizens. The industry also directly paid $735,990 for data processing costs incurred by the Department to gather and process automobile statistical information. Other costs include capital surplus requirements for a company to be licensed and preparation of an annual report.

Besides the direct and easily identifiable costs to the industry due to regulation there are many hidden costs. A percentage of any company's expenses can be attributed to regulation although an exact amount cannot be pinpointed. Any time a company spends time and manpower as result of regulation, whether it is filing a rate request with the supporting documentation or working with consumer assistants on a complaint, a cost is involved. All of these costs are passed to the consumer in the premiums that are charged.

Just as there are direct and indirect costs as a result of regulation there are also direct and indirect benefits due to insurance regulation. The direct benefit from regulation is the rate-making process mandates that rates be adequate but not excessive. It is generally agreed by industry and Department officials that without the present regulation of homeowners and automobile insurance, these rates would increase. The indirect benefits are also important. Some of these benefits include: ensuring through periodic audits that a company is solvent and that funds are available to pay policyholders' claims; assisting consumers in resolving complaints; ensuring fair claims handling; preventing discriminatory underwriting practices; and making sure that insurance is available.

In conclusion, the cost of any regulation is passed on to the consumer and the regulation of insurance is no exception. However, the overall benefits to the consumer from this regulation are far greater than any increased costs due to regulation.

(2) Economic, fiscal and other impacts that would occur in the absence of the administering of the programs or functions of the agency under review.

The regulation of insurance by individual states started in the late 1800's and South Carolina began active regulation in 1908. In 1945, the U. S. Congress passed the McCarran-Ferguson Act which stated that insurance regulation by individual states was in the public interest. This law exempted insurance from Federal oversight to the extent that insurance was regulated by the states

and said the Federal Government would regulate insurance if the states did not. Thus, the first consequence in the absence of a Department of Insurance would be Federal regulation.

With Federal regulation, South Carolina State Government would no longer have a role in an industry which collected more than $1.6 billion in premiums from its citizens. A centralized, Federal system of insurance regulation would be less responsive to the particular needs of South Carolina. South Carolinians would find it more difficult to have any input into the insurance system. One of the main advantages to individual State regulation is that states have been able to innovate and mold their insurance system to meet the needs of their people.

Another impact of the absence of State regulation is the loss to the State of more than $32 million a year in generated revenue. It is possible this revenue could be collected by another agency like the Tax Commission but additional personnel would have to be added to handle this function.

The economic and social impact of the absence of insurance regulation could be catastrophic. One of the Department's functions is the examination of companies' books to prevent insolvency. If a company becomes insolvent, policyholders would not only lose the premiums they paid, but there would be no funds to pay claims. This can mean an economic catastrophe for consumers and in many cases the government would be called on to provide economic and social relief.

Consumers would be hurt in other ways by the absence of regulation. Many insurance rates would increase if left unregulated. Problems with insurance availability, discrimination and

subjective underwriting practices would reappear. Consumers would no longer be able to receive assistance in dealing with companies nor have any recourse if companies did not pay claims fairly and promptly. The absence of company and agent licensing would mean that the marketplace could be flooded with unscrupulous companies and agents. The "buyer beware" philosophy would literally be in effect for a technical and complex product which few people fully understand but which has a tremendous economic impact on their lives.

In conclusion, the absence of the Department's programs and functions would leave South Carolinians without immediate protection from a billion-dollar industry. At best the Federal Government would take over the regulatory responsibilities and it could not be totally responsive to the needs of South Carolina citizens.

(3) The overall cost, including manpower, of the agency under review.

The department of Insurance cost $2,624,896 to operate in FY 77-78 of which over $1.6 million (62%) was spent for personal service. While the operating budget has doubled over the past five years the number of personnel has remained relatively unchanged. In 1973 the Department had 98 personnel and in 1978 there were 106 classified staff members.

Major increases in the Department's operating costs came with the establishment of the State Rating and Statistical Division in 1974. The Department has contracted with a data processing firm (AIPSO) to carry out its responsibility to establish statistical plans and compile data on automobile insurance premiums and losses.

This cost has accounted for the majority of the 104% increase in the Department's budget over the last five years. However, all of these data processing expenditures are by law recouped from the automobile insurance industry.

The costs to the State of regulating the insurance industry can be divided into two areas, administrative costs and compliance costs. Administrative costs include those expenses necessary to operate and administer regulatory activities such as office space, equipment, supplies, communications and administrative personnel salaries. Compliance costs are incurred on behalf of the public interest to ensure that statutes and regulations are carried out. The Licensing and Taxation Division, Market Conduct Division, Financial Condition Division and the Rating and Statistical Division comprise the expenditures in the compliance area.

A more detailed discussion of the organization operation and cost of the agency can be found in Chapter 1 pages 20 and 21.

(4) The efficiency of the administration of the programs or functions of the agency under review.

The Department is able to efficiently process a large volume of work. It replies to consumer complaints and adequately handles the routine processing duties of agent and company licensing, tax collection and approval of forms. Its system to ensure that companies meet financial standards is efficient and adequate. Despite an increase in the volume of work processed over the last several years, the Department's staff increased only slightly over the last five years. The Department's reorganization based on the McKinsey consultant study in 1975 has helped its efficiency.

There are still areas where improvement is needed. The heavy workload in routine forms processing and accident and health rate filings needs to be reduced through a more streamlined system of review.

(5) The extent to which the agency under review has encouraged the participation of the public and, if applicable, the industry it regulates.

The Insurance Commission, which directs the Department, is composed of members from both the insurance industry and the "general" public. The five member Commission is composed of one company executive, one insurance agency owner and three business persons who have no connection either directly or indirectly with the insurance industry. Rate hearings are public when the company requesting the increase writes a premium volume of over $500,000. Notices of the hearing are published in the media as set by law. However, members of the public seldom attend. The State Consumer Advocate is now available to represent the public at rate hearings.

The Department does not solicit public or industry views while making its legislative proposals. The insurance industry, though, has a strong lobby and makes its views known. While the public may express its views to the Department or the Commission and attend rate hearings if it so wishes, it rarely does, and the Department does not actively encourage public input into insurance regulation.

(6) The extent to which the agency duplicates the services, functions, and programs administered by any other State, Federal or other agency or entity.

The Department of Insurance does not duplicate the services, functions or programs of any other State, Federal or local agency. While some State agencies, such as the Industrial Commission, are involved with insurance such as Workman's Compensation, the Department of Insurance does not duplicate their functions. The Department is the only government agency regulating insurance in South Carolina.

(7) The efficiency with which formal public complaints filed with the agency concerning persons or industries subject to the regulation and administration of the agency under review have been processed.

The Department of Insurance is able to efficiently process complaints. In 1978, seven consumer analysts handled 3,347 complaints and 3,625 inquiries from members of the public. The Department also performed 55 marketplace-related and 20 designated agent investigations in FY 77-78. The Department processes complaints promptly, sending a letter to the company within one day that the complaint is received. The actual time it takes a complaint to be resolved is longer but much of this depends on the company. The Council's scientific sample of complaints made in 1978 found the average time of resolution of a complaint to be 46 days.

Although the Department processes complaints efficiently, it could be more aggressive in aiding consumers and detecting unfair marketing practices. See page 41 for more detail.

(8) The extent to which the agency under review has complied with all applicable State, Federal and local statutes and regulations.

The Department of Insurance has complied with applicable rules and regulations except in the following areas:

- It has not promulgated minimum standards for individual accident and health insurance as directed by State law (see p. 29);
- Its method of reimbursing financial examiners for travel and other expenses is not in compliance with State law (see p. 49);
- It has not tested auto insurance rating and classification plans annually as directed by statute. Until this time sufficient data has not existed to accomplish this.
- It has not initiated the means with which to enforce the Unfair Trade Practices Act and investigate the conduct of insurance agents and companies in the marketplace (see p. 41).

APPENDIX II

INSURANCE SURVEY RESULTS

In October of 1978, four questionnaires were designed and mailed out to collect information about the South Carolina Department of Insurance. Separate questionnaires were mailed to insurance agents, insurance companies, those individuals who filed insurance related complaints with the Department of Insurance, and members of the general public. The responses to these questionnaires provided insight into the functioning and impact of the Department.

Copies of the questionnaires with the compiled responses follow. The figures in the answer spaces represent the percentage of those responding to the question who provided that particular answer. Because not every respondent answered every question, the number responding to each question is listed in the margin. For example, N=50 means that 50 respondents answered that question. The letters R.D. in the margin denote that figures in the blanks are raw data. Raw data is provided in these cases because some questions were designed to allow the respondent to provide more than one answer to that question. Asterisks denote the average (mean) response where appropriate.

The following is a summary of some of the significant facts revealed by the various questionnaires.

- Forty percent of the general public were not aware that the South Carolina Insurance Department existed.
- Seventy-one percent of the general public were not aware that a Market Conduct Division existed to handle insurance related complaints.

- Eighty-five percent of the general public thought it would be beneficial for the Insurance Department to publish an insurance buying guide.

- Forty-two percent of the general public has either a poor or no understanding of the terms used by the insurance industry.

- Forty-six percent of the companies considered the Departments process for reviewing and approving requested rate increases to be slow.

- Under the Uniform Merit Rating Plan, 69.2 percent of the customers of responding companies receive safe driver discounts while 20.3 percent are surcharged.

- Continuing education programs for insurance agents are made available by 74.2 percent of the companies responding.

- Sixty-four percent of licensed agents responding thought the Insurance Department should institute penalties consisting of monetary fines or temporary license suspension for minor offenses.

- Only 34% of the responding agents utilized continuing education courses to remain abreast of changes in insurance laws and regulations.

- Thirty-one percent of the agents had not participated in an instructional course offered by a company or agents' association in the past 5 years.

- Eighteen percent of the agents had either been terminated or suffered a reduced commission because they insured "bad-risk" drivers with their company.

AGENT QUESTIONNAIRE

Questionnaires were sent to a randomly selected sample of 326 insurance agents holding South Carolina licenses. Of these agents, 144 (44%) responded.

1. Do you feel as if the agents licensing examination accurately measured your skill and knowledge of the subject area in which you took the examination?

N=138 Yes 73.2 No 26.8

2. Do you feel as if the skill and knowledge the examination measured is necessary in your day-to-day business activities?

N=140 Yes 69.3 No 30.7

3. Was the examination given in a suitable location at a convenient time?

N=139 Yes 95 No 5

4. Do you believe that the examinations are graded fairly and accurately?

N=139 Yes 95 No 5

5. Currently, the policy of permanent suspension of an agent's license is the only administrative action which can be taken against an agent guilty of misconduct. Do you believe the Insurance Department should institute some lesser penalties (i.e., monetary fines or temporary license suspension) for minor offenses?

N=138 Yes 64.5 No 35.5

6. Do you feel that the requirement for an agent to take a separate examination for each line of insurance in order to be licensed a fair one?

Yes 89.4 No 10.6

7. What instruction in insurance and in insurance laws did you have prior to being licensed as an agent? (check)

R.D.

a) High School Course Work	17
b) College Course Work	20
c) Examination Study Manual	129
d) Trade or Company Course Work	74
e) Other (Specify)	___

8. In what manner do you keep abreast of changes in South Carolina insurance laws and regulations? (check)

R.D.

a) Newspaper	93
b) Trade Publications	69
c) Department Correspondence	50
d) Continuing Education Courses	49
e) Company Publications	96
f) Other (Specify)	12

9. Indicate the last time you took an insurance instructional course offered either by an insurance company or an agents' association. (check one)

N=125 Within the last: 6 months 37.6 | 1 year 15.2 | 2 years 16 | 5 years 7.2 | More than 5 years 24

10. Have you ever had contact with the Insurance Department in order to obtain information?

N=142 Yes 43.7 No 56.3

If yes, how would you characterize the Department's response? (check three)

N=62 a) Prompt Response 96.8/Slow Response 3.4
N=56 b) Provided Accurate Information 98.2/Provided Inaccurate Information 1.8
N=60 c) Were Generally Helpful 100/Provided Little or No Help 0

11. If you write automobile insurance, has a company ever terminated your contract or lowered your commission because you placed "bad-risk" drivers with the company?

N=73 Yes 17.8 No 82.2

12. Do you feel that the regulations promulgated by the Insurance Department hinder your conduct in the marketplace?

N=134 Yes 10.4 No 89.6

13. Does your company require its agents to refund to them the annual agents license fee?

Yes 20.7 No 79.3

14. What do you believe the main duty of the Insurance Department should be? (Explain)

15. Other Comments

This space is for any other comments you might have on the status of South Carolina's insurance system.

R.D. = Raw Data: The number responding to each option when more than one response was possible.

N = The number of respondents answering a question.

* = The average (mean) of all responses to a question.

GENERAL PUBLIC QUESTIONNAIRE

Questionnaires were sent to a randomly selected sample of 500 members of the general public drawn from motor vehicle registration records at the Department of Highways and Public Transportation. Of these individuals 120 (24%) responded.

N=120 (1) Are you aware of the existence of the South Carolina Department? Yes 60 No 40

N=120 (2) Are you aware that the Insurance Department has a Market Conduct Division whose purpose is to handle consumer complaints? Yes 29.2 No 70.8

N=119 (3) Have you ever had any direct contact with the South Carolina Insurance Department? Yes 12.6 No 87.5
If yes, for what purpose did you have this contact? (Explain)

How would you characterize the Department's response? (Check three)

N=17
(a) prompt response 88.2/slow response 11.8
(b) provided accurate information 100/provided inaccurate information 0
(c) were generally helpful 91.7/provided little or no help 8.3

N=116 (4) Do you believe that it would be beneficial to consumers for the Insurance Department to publish small informative booklets on how to purchase different types of insurance? Yes 85.3 No 14.7

N=114 (5) In your opinion would the publishing of such booklets be: (check one)

(a) A justified use of the taxpayers' money 75.4
(b) A waste of tax money 17.5
(c) No opinion 7

N=115 (6) Do you feel as if you have ever been improperly or unfairly treated by an insurance company? Yes 40 No 60 If yes, how? (check one or more)

R.D.
(a) Inadequate claims benefits 17
(b) A company has denied your coverage 7
(c) Unjustified cancellation of your policy 8
(d) Other (Specify) 20

N=114 (7) Which of the phrases below best characterizes your understanding of insurance terms used by the insurance industry? (check one)

(a)	Good understanding	11.2
(b)	Fair understanding	46.6
(c)	Poor understanding	37.1
(d)	No understanding	4.4

N=113 (8) Do you feel as if you understand your insurance policy(s) and could explain to another person the types of coverage you have and the benefits you are entitled to?
Yes 46.9 No 53.1

N=95 (9) Do you feel there is a public need for the South Carolina Insurance Department? Yes 89.5 No 10.5

N=54 If yes, do you feel the Department is meeting this public need? Yes 35.2 No 64.8

(10) In your opinion, what do you think should be the main duty of the Insurance Department? (Explain)

R.D. = Raw Data: The number responding to each option when more than one response was possible.

N = The number of respondents answering a question.

* = The average (mean) of all responses to a question.

COMPANY QUESTIONNAIRE

The 50 insurance companies doing the most business in terms of premiums dollars in each of four lines were selected to receive questionnaires. Those lines were Accident and Health, Property and Casualty, Life, and Health. Because many companies offer more than one line of insurance, some companies were among top 50 groupings two or more times. Overlapping was prevented by sending only one questionnaire to companies with multiple top 50 lines. As a result of this, questionnaires were sent to 132 companies. Of these, 70 (53%) responded.

N=65 1. Do you feel that the process for obtaining a license to market insurance in South Carolina is conducted in an efficient manner? Yes 95.4 No 4.6

N=66 2. Do you believe that amounts of capital and unassigned surplus as required by statute in South Carolina are reasonable and do not place an undue hardship on insurance companies? Yes 98.5 No 1.5

N=41 3. In your opinion, are the financial examiners from the South Carolina Insurance Department who conduct periodic financial examinations of your company qualified to perform this task? Yes 92.7 No 7.3

4. Do you feel the process as conducted by the South Carolina Insurance Department for the review and approval of rate increases made by your company to be: (check applicable responses)

N=49 (a) Fair 85.7 Unfair 14.3
N=48 (b) Expedient 54.2 Slow 45.8

5. Do you feel the process as conducted by the South Carolina Insurance Department for the review and approval of policy forms used by your company to be: (check applicable responses)

N=65 (a) Fair 87.7 Unfair 12.3
N=58 (b) Expedient 79.3 Slow 20.7

N=20 6. If your company writes automobile insurance, please answer the following question.

(a) In order to surcharge customers under the S. C. Uniform Merit Rating Plan, do you obtain motor vehicle records from the South Carolina Department of Highways and Public Transportation? Yes 100 No 0

(b) Under the Uniform Merit Rating Plan, what percentage of your South Carolina customers:

N=16 - quality for the Safe Driver Discount 69.2*
N=15 - receive neither a discount nor a surcharge 11.8*
N=15 - are surcharged for driving violations 20.3*

N=65 7. Do you provide any training program to individuals who seek to become agents for your company in South Carolina? Yes 69.2 No 30.8 If yes, specify what kind of training program.

N=66 8. Do you provide any type of continuing education in insurance for your agents in South Carolina? Yes 74.2 No 25.8 If yes, specify what type of training program.

N=67 9. In your opinion, are the insurance statutes, laws and regulations in effect in South Carolina adequate for the conduct of business in this State? Yes 97 No 3 If no, what major changes in the insurance statutes, laws, and regulations in effect in South Carolina would your company favor?

N=67 10. Do you feel as if the South Carolina insurance laws and regulations are adequately enforced? Yes 97 No 3 If no, in which areas are they not adequately enforced?

N=68 11. Have you ever had contact with the South Carolina Insurance Department in order to obtain information? Yes 97.1 No 2.9 If yes, how would you characterize the Department's response? (check three)

N=65 (a) Prompt Response 96.9/Slow Response 3.1
(b) Provide Accurate Information 98.4/Provide Inaccurate Information 1.6
(c) Were Generally Helpful 96.8/Provided Little or No Help 3.2

12. What do you believe the main duty of the South Carolina Insurance Department should be? (Explain)

13. Any other comments you might have on the South Carolina Insurance Department or the insurance system in South Carolina will be appreciated.

R.D. = Raw Data: The number responding to each option when more than one response was possible.

N = The number of respondents answering a question.

* = The average (mean) of all responses to a question.

COMPLAINANT QUESTIONNAIRE

Questionnaires were sent to a randomly selected sample of 300 individuals who logged complaints with the South Carolina Department of Insurance during Fiscal Year 1977-78. Of these individuals, 165 (55%) responded.

1. Did you find the South Carolina Department of Insurance to be of any assistance in resolving your consumer complaint?

N=162 Yes 75.9 No 24.1

2. In your opinion, was this complaint "successfully resolved?"

N=160 Yes 64.4 No 35.6

3. Do you feel that there was any additional action the Department could have taken in order to resolve your complaint to your satisfaction?

N=157 Yes 36.3 No 63.7

4. Did the action taken by the Insurance Department regarding your complaint address the specific problem you asked about?

N=161 Yes 82.6 No 17.4

5. Do you feel that the Department's analyst who assisted you was competent and handled your complaint in an efficient manner?

N=157 Yes 75.2 No 24.8

6. Do you believe that your complaint was resolved in a reasonable amount of time?

N=159 Yes 63.5 No 36.5

If no, to whom do you attribute this slowness of response? (check)

R.D.

Insurance Department	16
Your insurance company	49

7. Based on the way in which your complaint was handled, do you feel the Insurance Department is: (check one)

N=151

(a)	consumer-oriented	37.1
(b)	neutral	40.4
(c)	industry-oriented	22.5

8. If, in the future, you had a problem or complaint about insurance would you go to the Insurance Department for help?

N=158 Yes 84.2 No 15.8

9. How did you learn that the Department of Insurance has a division which handles consumer complaints?

N=157

Specify:	Called Commission	6.4
	Prior knowledge	31.2
	Referred by company or agent	15.9
	Other	46.5

R.D. = Raw Data: The number responding to each option when more than one response was possible.

N = The number of respondents answering a question.

* = The average (mean) of all responses to a question.

APPENDIX III

COMPARISON OF INSURANCE SYSTEMS IN NORTH CAROLINA AND SOUTH CAROLINA

	North Carolina	South Carolina
Compulsory Liability Insurance	Yes	Yes
Mandatory Writing of Insurance	Yes	Yes
Minimum Liability Limits	15/30/5	15/30/5
Reinsurance Facility	Yes	Yes
Companies Must Write Liability Insurance	Yes	Yes
Companies Must Write Physical Damage Insurance	No	Yes
Merit Rating Plan/Surcharge System	The surcharge is based on a percentage of the base premium of the individual driver.	The surcharge is a flat fee.
Territories	1 - Statewide rating territory.	8 - Different rating territories.
Death Rate (1977)	3.8 deaths per 10,000 vehicles, 26.8 deaths per 100,000 population.	4.2 deaths per 10,000 vehicles, 36.6 deaths per 100,000 population.
Accident Severity for 1 Company Property Damage	Cost $362.50 per accident.	Cost $424.75 per accident.
	(Difference of 17%, $62.25 per claim.)	
Accident Severity for 1 Company Bodily Injury	Cost $1,791	Cost $1,977
	(Difference of 10.4%, $186 per claim.)	
Legal Suit Frequency for 1 Company (1976) Property Damage	Of 28,191 claims, 88 (.32%) brought legal action.	Of 9,438 claims, 72 (.76%) brought legal action.

	North Carolina	South Carolina
Legal Suit Frequency for 1 Company (1976) Bodily Injury	Of 6,874 claims, 456 (6.6%) brought legal action.	Of 2,372 claims, 538 (22.7%) brought legal action.
Punitive Damages	Are not covered by liability insurance are seldom pled and almost never recovered.	S. C. is the only state which requires punitive damages to be covered by liability insurance.
Negligence	Contributory negligence - A driver can be found to have contributed to an accident and denied damages.	Comparative negligence - At fault drivers can collect for damages.
Statute of Limitations	3 years	6 years - the longest in the nation.
Ease of Filing Suit	Judge or clerk of court must approve summons and complaint.	Plaintiff's lawyer may issue summons complaint.
Physical Examination	Plaintiff may be required to submit to an adverse physical examination.	Plaintiff is not required to submit to physical examination.
Interrogatories (A series of formal written questions used on judicial examination of a party)	Written interrogatories are unlimited.	Only 6 standard written interrogatories are allowed.
Jury Selection	Prospective jurors are subject to voir dire (test of competence) examination by both counselors.	Voir dire examination is only permitted in cases involving punishment.
Jury Exemptions	Exemption from jury duty is very limited.	Exemption from jury duty is obtained rather easily.

	North Carolina	South Carolina
Conduct of Judges	Judges are permitted to fairly summarize and comment upon evidence.	Judges cannot comment upon evidence.
Presentation of Verdict	Factual issues are reduced to writing and presented to the jury. The jury must then answer the issues in writing. This requires the jury to logically address the issues of cause, negligence and damage.	No such requirement.

APPENDIX IV

MODEL FEDERAL

STANDARDS FOR NO-FAULT MOTOR VEHICLE INSURANCE

The proposed Federal no-fault standards embody the basic no-fault principle: to assure every motor vehicle accident victim the right to prompt and adequate recovery of economic losses, such as medical, rehabilitation, and wage loss expenses, without raising insurance costs. The ability to pay every victim without additional cost is achieved by limiting a victim's right to sue in tort for intangible damages.

This Federal proposal sets forth certain basic minimum standards for State no-fault benefit plans. All motor vehicle owners would be required to purchase first-party (no-fault) coverages of at least the minimum benefit levels specified. State plans may exceed the minimum standards and thus Federal pre-emption beyond the minimum standards would not be involved. The primary provisions of any no-fault plan are its benefit levels and its restriction on lawsuits (called a "threshold"). The basic benefits pavable are:

(1) Medical and rehabilitation expense up to $100,000 indexed to State medical care costs;

(2) Work loss expense of up to $12,000 computed on the basis of a State/nationwide fraction of average incomes;

(3) Replacement service expense (e.g., household help) for 1 year computed on the basis of $20 per day multiplied by a State/nationwide fraction of average incomes;

(4) Death benefit of $1,500;

(5) Additional coverages in reasonable amounts for additional medical, rehabilitation, work loss, replacement service, and death benefits, which must be available on an optional basis. Standards do not extend to collision, property, or comprehensive coverages.

The tort restriction (threshold) is a verbal limitation. It would limit tort liability for general damages (noneconomic losses or pain and suffering) to cases where the victim (1) dies; (2) suffers serious and permanent injury; (3) receives significant permanent scarring or disfigurement; or (4) is continuously disabled for more than 180 days. An accident victim could sue in tort for economic losses beyond those covered by no-fault benefits.

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June 19, 1979

Mr. George L. Schroeder
Executive Director
Legislative Audit Council
500 Bankers Trust Tower
Columbia, South Carolina 29201

Re: Audit of the South Carolina Insurance Commission by the Legislative Audit Council

Dear Mr. Schroeder:

The Insurance Commission and the Staff of the Insurance Department welcome the opportunity to respond to the very thorough and extensive study of the performance and duties and responsibilities of the Commission and the Department. The Audit Council Staff was most professional in the manner in which it conducted the audit and we appreciate the steps taken by your Staff members to assure that the day to day operations of the Department were not interrupted during the course of the audit.

The nature of our response will be, for the most part, general in nature since we have no basic disagreement with most of report. Some issues will be addressed with specific comment, principally because of their technical and complex nature, our prior experience and pending legislation. Finally, we believe that some recommendations of the Legislative Audit Council are legislative prerogatives rather than administrative prerogatives. The Commission and Staff have always been responsive to Legislative requests and will, in the future, respond affirmatively to Legislative initiatives with personal assistance, research and technical advice.

We are pleased that the Legislative Audit Council's Report recognizes the objectives of the McKinsey and Company, Inc. Report of 1975, Organizing for Effective Insurance Regulation, and our efforts to fully implement

that program. The austere fiscal policy of the State of South Carolina for the past several years has had a direct impact on the full implementation of the McKinsey Report as well as other initiatives developed internally by the Commission and the Staff. It would appear that this situation will not improve in the near future, in view of the briefing by the State Planning Director on June 14, 1979, on Agency Planning through 1984 (State Five-Year Plan). It was clearly indicated by the State Planning Director, from the analysis of the five-year agency plans, that expenditures would exceed anticipated revenues by more than one billion dollars. In any event, we do not intend to use the crutch of inadequate financial resources as an excuse for deficiencies, but will aggressively realign priorities and make maximum use of the resources allocated to us.

We would now like to address ourselves to the major areas outlined in the Report as follows:

1. Lack of Evaluation and Monitoring of the South Carolina Insurance System (Page 22, et seq.)

   We concur with this analysis and will proceed to put the recommendations into effect as soon as possible.

2. Lack of Standards for Individual Accident and Health Insurance (Page 29, et seq.)

   We concur with the substance of the analysis and offer the following specific comments:

   a. At its Regular Meeting on June 14, 1979, the Insurance Commission authorized the promulgation of a comprehensive regulation which will implement the minimum standards law for accident and health insurance and standards for Medicare type coverages. This regulation will be prepared and processed in accordance with the requirements of the Administrative Procedures Act and will be pre-filed for prompt Legislative action when the General Assembly reconvenes in January, 1980. Comparison guides and consumer information will be published in accident and health insurance in addition to guides for other lines of insurance as recommended by the Report. Finally, we would urge that the loss ratio benchmark of 50% (or greater) be placed in the statute.

3. Lack of Regulation of Industrial Insurance (Page 35, et seq.)

We concur that this line of insurance needs attention and we will proceed to draft enabling legislation along with appropriate regulations. There are a number of technical problems involved which will be extremely difficult to accomplish without the full support of the General Assembly. For example, all industrial life insurance policy forms must have the prior approval of the Department and meet minimum standards for non-forfeiture benefits under current law. To raise the standards will require an extensive actuarial review of mortality, interest and expenses in today's economy. The "old fashioned" weekly premium business is a declining book of business since insurance companies themselves are making a concerted effort to reduce expenses by converting this business to monthly debit ordinary business. On Page 35 of the Audit Report, reference is made to the fact that industrial applications for insurance are not made a part of the contract. The quickest solution to this problem would be the adoption by the General Assembly of the Commission's 1979 Legislative Recommendation that if the application is not a part of the contract, the contract thereof may not be used to deny a claim. Our bill to accomplish this is currently pending in the General Assembly and we will renew our efforts at the 1980 Session if it is not enacted before adjournment in 1979.

4. Inadequate Consumer Protection and Assistance (Page 41, et seq.)

We concur that this area should receive a greater emphasis as soon as possible. As noted in the McKinsey Report, this would be a Market Conduct Division function. Since we have not yet been able to obtain the resources to provide totally effective consumer protection and assistance, we compared the relative cost of toll-free numbers and satellite offices throughout the State. Both appeared to be prohibitive in 1976-1977 and the Commission has again requested that the Staff provide a current analysis of the study. In January, 1979, funds for a toll-free number were requested in the Department's supplemental appropriation request. We expect to receive the funds in the near future.

5. Violation of State Law for Travel Expenses of Examiners (Page 49, et seq.)

We concur. Commencing with Fiscal Year 1979-80 on June 22, 1979, the examiners will be reimbursed in the same manner for travel expenses as other State employees.

6. Continuing Education Requirements for Agents (Page 52, et seq.)

We agree with the recommendation, although we may have some minor changes pending further analysis by Staff. In any event, a Legislative proposal will be prepared for consideration by the General Assembly.

7. Other Management Areas (Page 60, et seq.)

We concur with all of the recommendations of the Council. Some of these can be accomplished immediately, i.e., the recommendation with respect to greater diligence in monitoring travel related expenses and motor vehicle usage; and flattening of expenses in rate filings. Others can be phased in during the next Fiscal Year after the completion of brief Staff studies as to method. The preparation of Training and Procedures Manuals will require a considerable amount of time and effort. We will begin work on the manuals as soon as possible, establish priorities and set target dates for completion.

8. The South Carolina Automobile Insurance System (Page 68, et seq.)

The Department Staff has been studying the private passenger automobile risk classification system for more than eighteen months. The statistical data has been collected and analyzed, not only with respect to class relativities, but territorial relativities. The application and effectiveness of the Merit Rating Plan is inter-woven with the fabric of the risk classification system and has likewise been the subject of considerable review. In early 1979, several bills were introduced to eliminate one or more of the current rating factors (or all of them, leaving the individual driving record as the sole basis for rating) and the Department made a presentation to a full Legislative Committee on February 15, 1979. Our current data indicates that the elimination of age, sex

and marital status without experience tested and credible data as a substitute therefor would produce substantial price increases for 80% of the insured motorists in order to give the remainder a relatively modest decrease. We believe this kind of issue calls for a Legislative decision because of the economic impact on such a large percentage of the driving public.

We concur with respect to the Merit Rating Plan recommendation on Page 86, that the Plan should be strengthened to provide an incentive for safer driving. In late 1974, the Commission proposed a much stronger Merit Rating Plan which, after being reviewed by the Joint Legislative Automobile Liability Insurance Study Committee, was revised at that Committee's request. Analysis of the data accumulated under the revision indicated a need for change and the Plan was amended July 1, 1977. Two years of experience under that Plan will be available shortly after July 1, 1979, and we will use that data as a credible basis for strenghtening the Plan. However, we must point out that there is a point of diminishing return in any Merit Rating Plan where heavy surcharges produce a higher percentage of uninsured motorists on the highways.

We concur that regular audits should be conducted to insure compliance with proper rating procedures, particularly with respect to the surcharges required by the Merit Rating Plan.

In 1977, Governor Edwards, at the request of the Insurance Department, appointed an Inter-Agency Committee to review, analyze and make recommendations on the Motor Vehicle Reporting System. Some alternatives were not incorporated in the final report which we felt would strengthen the Motor Vehicle Reporting System. We intend to pursue these alternatives.

We agree that there should be more effective coordination between the Department of Highways and Public Transportation and the Insurance Department in various areas of mutual concern. The Highway Department has been most reasonable in our discussions but has raised questions for which we have been unable to provide practical

solutions. One is the funding requirement of computer programming and associated costs for further refinement of the Motor Vehicle Reporting System and the other is the effect of the Federal Privacy Act and the release of information relating to an individual's driving record without his consent. These are serious problems and will continue to receive our attention.

9. Private Passenger Automobile No-Fault Insurance (Page 87, et seq.)

We quote from the Commission's 1972 Legislative Recommendations:

> "We think the matter should be thoroughly explored by reviewing the good and bad points in the present system, the experience in other States which have adopted "no fault" legislation and the requirements which may be imposed at the Federal level. Thereafter, a decision must be made regarding the method of compensating persons involved in automobile accidents."

We believe that the issue of No-Fault should be a Legislative initiative. We, therefore, recommend that an appropriate Legislative Committee make a study of this proposal, solely on its merits. The Commission and Department are available for research, data compilation and technical assistance.

In summary, the Commission and the Department believe that our efforts to provide the best overall regulation of insurance in the light of the complexities of modern society have been fruitful. We have attempted to provide this regulation with a minimum of resources and have attempted to manage by objectives as contemplated by the McKinsey Report.

Finally, we would like to observe that, in our opinion, the study by the Legislative Audit Council is an independent confirmation that the insurance statutes of the State of South Carolina need to be recodified and modernized to give the Department the necessary tools to deal with the insurance system now and in the future. There has not been a general codi-

fication of the insurance laws since 1947 after Congress adopted Public Law 15, the McCarran-Ferguson Act. This codification has been repeatedly recommended in recent years by the Commission in its Annual Report to the Governor and the General Assembly. We believe that the time, effort and money would be well worth the benefits which would inure to the citizens of South Carolina.

Yours very truly,

CLAUDE E. McCAIN
Chairman
South Carolina Insurance Commission

JOHN W. LINDSAY
Chief Insurance Commissioner

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